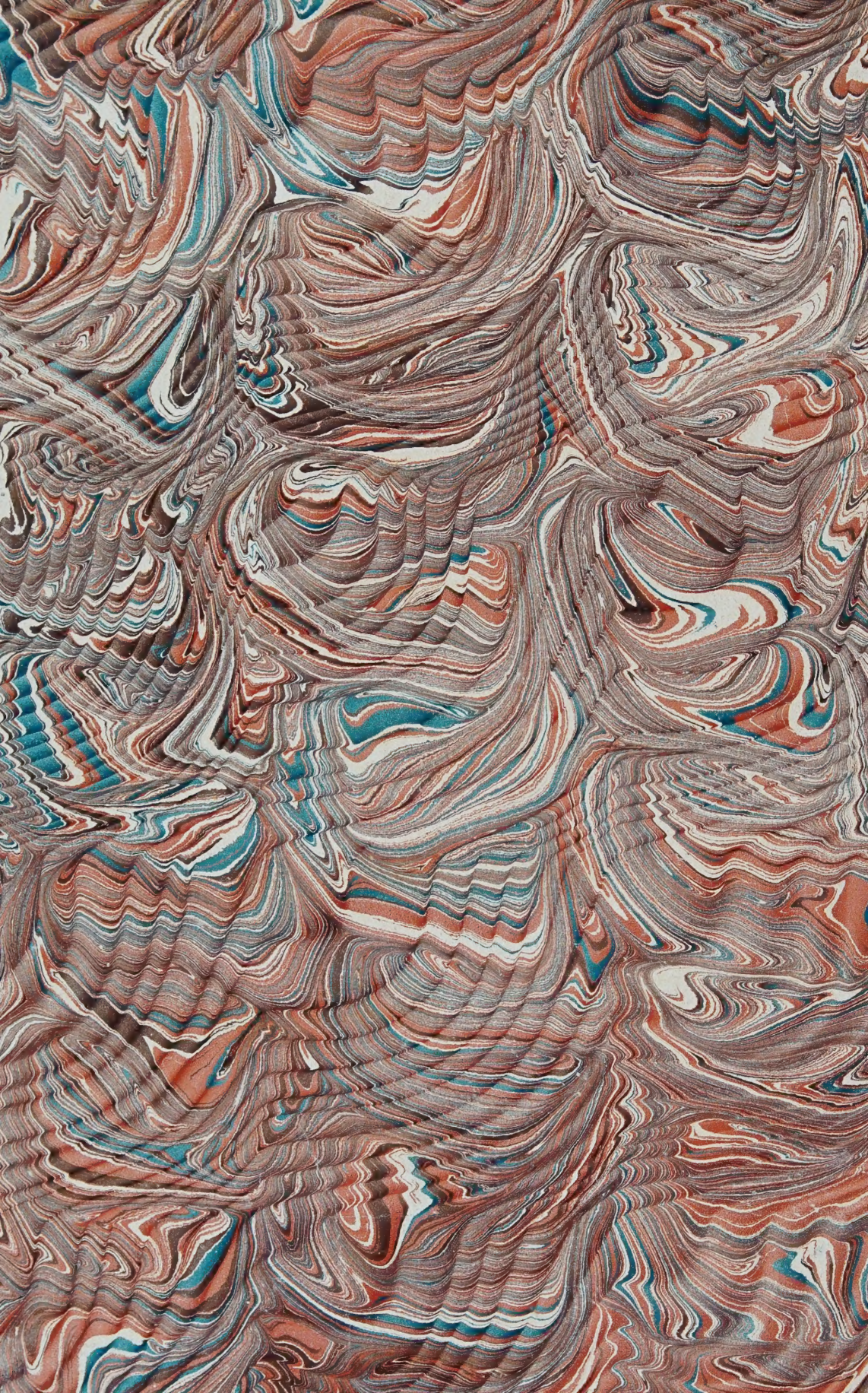


W. C. TRULL  
NEW YORK

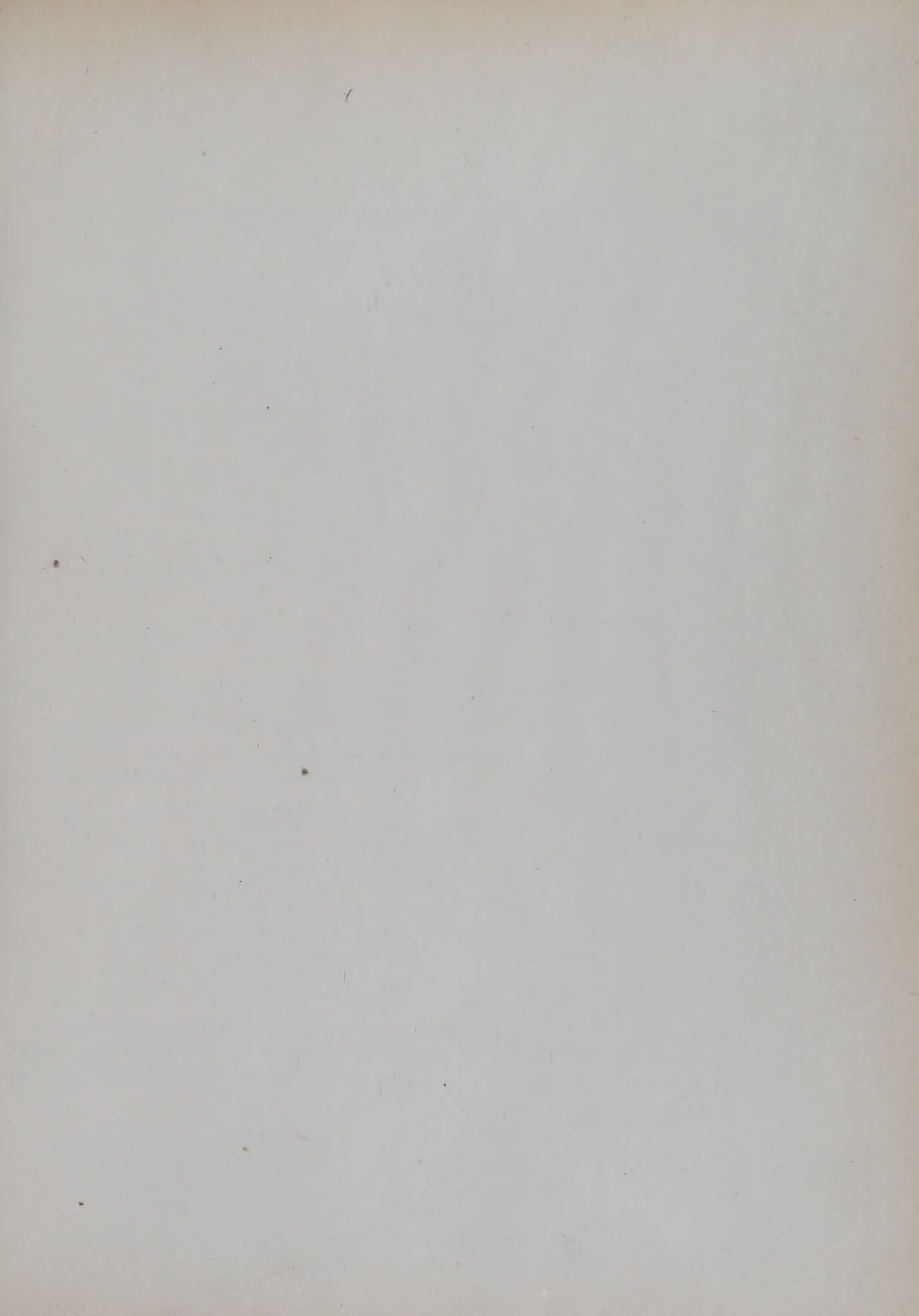














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CONTINENTAL INSURANCE COMPANY

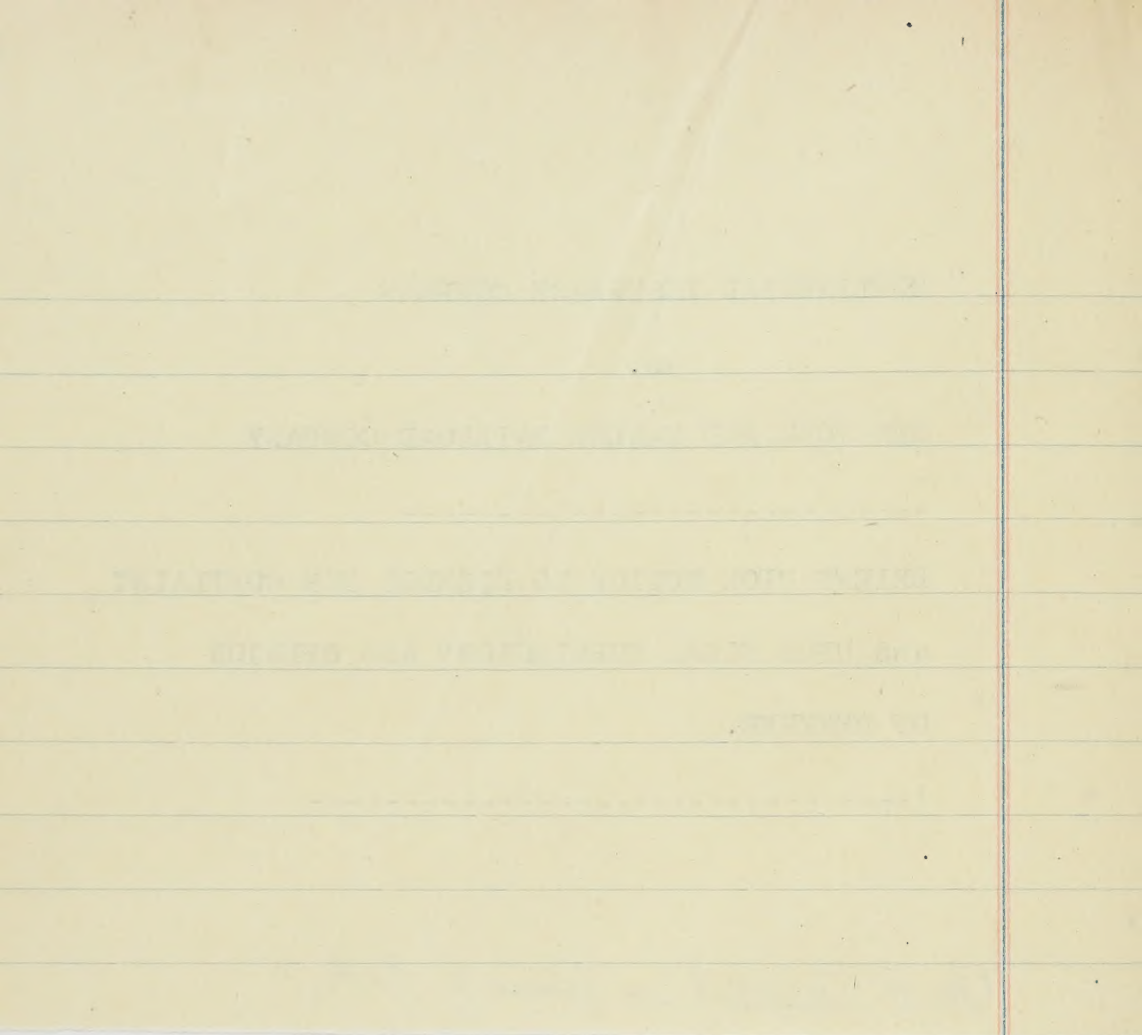
vs.

NEW YORK AND HARLEM RAILROAD COMPANY

-----  
BRIEFS, UPON MOTION TO DISMISS THE COMPLAINT,  
and, UPON, FINAL SUBMISSION?, AND, OPINION  
OF REFEREE.

) -----

(N. C. Trull) on front of book.



# N. Y. Supreme Court.

COUNTY OF NEW YORK.

CONTINENTAL INSURANCE COMPANY,  
Plaintiff,

AGAINST

NEW YORK AND HARLEM RAILROAD  
COMPANY and NEW YORK CEN-  
TRAL AND HUDSON RIVER RAIL-  
ROAD COMPANY,

Defendants.

## Points for Motion to Dismiss Complaint.

Defendants move to dismiss the complaint at the opening of the trial on the ground that it does not state facts constituting a cause of action.

I. Such a motion is a matter of right, and if well taken it is the duty of the Court to grant it. It is equivalent to a demurrer and is to be decided on the same principles as apply to a demurrer.

*Coffin vs. Reynolds*, 37 N. Y., 640.

*Nethercott vs. Kelly*, 57 N. Y. Super. Ct., 27.

*Herbert vs. Duryea*, 87 Hun, 288.

*Tillotson vs. Nye*, 88 Hun, 101.

*Sheridan vs. Jackson*, 72 N. Y., 170.

II. On demurrer, conclusions of law are to be disregarded if not supported by proper allegations of fact, and plaintiff's construction of written instruments

is to be disregarded if not borne out by the instruments themselves as set forth in the complaint.

*Bogardus vs. N. Y. Life Ins. Co.*, 101 N. Y., 328.

*Greef vs. Equitable Life Ass. Society*, 160 N. Y., 19.

III. Plaintiff is a minority stockholder of the New York and Harlem Railroad, owning 4,408 out of 200,000 shares. Plaintiff sues on behalf of itself and all other stockholders similarly situated (other stockholders have joined in suit, to amount, however, of only shares in all).

The object of the suit is to set aside a so-called "second supplementary contract" entered into between the New York and Harlem Railroad Company and the New York Central and Hudson River Railroad Company, in the year 1898. This contract is not set forth in full nor is a copy thereof annexed to the complaint. Its purport is, however, set forth, according to the pleader's version of it, in paragraph XIV. of the complaint, and in paragraphs XV. to XXIV., inclusive. It is averred, in effect, to be an agreement supplementary to, and in modification of, the lease of the Harlem road to the Central Company, dated April 1, 1873. This lease is made part of the complaint, in full, as Exhibit A, and its construction and legal effect must, therefore, be determined by an examination of this exhibit and not by the allegations of the pleader as to the rights and liabilities thereby created.

See authorities (*supra*).

In determining whether the supplementary contract worked any legal injury to the Harlem Company or to its stockholders, or whether it was a contract which the directors of the Harlem Company had a right to enter into in the exercise of their sound discretion, the Court must ascertain for itself what was the true construction of the lease or whether the construction was so doubtful as to justify a compromise agreement, such as that alleged to have been contained in the "supplementary contract" of 1898.

We shall undertake to satisfy the Court that plaintiff's construction of the lease is not correct or, at any rate, that it is so far open to fair and reasonable doubt as to justify the compromise.

Before discussing this branch of the case, however, we challenge the right of minority stockholders to maintain this suit at all—so far, at least, as it is based upon the theory of constructive fraud.

It is alleged that there were common directors, constituting a majority of the boards of the two companies and participating in the making of the contract; and plaintiff seems to assume that that fact gives it the right to have the contract disaffirmed.

Such, however, is not the law.

A contract by a director or officer of a corporation with himself as an individual, is not void but merely voidable. It may be ratified by the company and will be considered ratified unless disaffirmed within a reasonable time.

*Salem Iron Co. vs. Lake Superior Cons. Iron Mines*, 112 Fed Rep., 239.

A stockholder cannot enjoin the execution of a contract made by his corporation with another corporation, within the corporate powers and free from fraud, on the sole ground that the promoters of the contract were directors in both corporations.

*Burden vs. Burden*, 159 N. Y., 288.

*Burland vs. Earle*, Privy Council, Nov. 1901, App. Cases, 1902, Vol. 1, p. 83.

Minority stockholders are not entitled to maintain a suit to set aside a contract which can be ratified by the majority of the stockholders.

See cases cited (*supra*).

Conceding that plaintiff could maintain this suit on behalf of the corporation if he showed actual fraud or bad faith or showed that the contract was so grossly improvident as to justify a charge of misconduct on the part of the directors making it, the complaint wholly fails to make sufficient allegations to sustain

the suit on any such theory. Loose general phrases are, of course, of no avail, nor are charges of bad motives.

There is no specific allegation showing that the directors defrauded the company in any way, except, possibly, in the matter of the price at which the bonds were to be sold, a matter purely collateral to the main question. See *infra* Point VI.

Whether the contract was reckless or improvident as to the Harlem Company and its stockholders, that depends upon the *status* of affairs at the time the "supplementary contract" was entered into. This brings us back to the question heretofore raised—namely: Is plaintiff's construction of the lease and of the rights of the lessor and lessee company, respectively, correct or if correct is it so free from reasonable doubt as to make the "compromise agreement" an improvident surrender of the rights of the Harlem stockholders by its directors?

IV. We claim, first, that plaintiff's construction of the lease is incorrect; second, that it is, at any rate, open to reasonable dispute; and, third, that the directors of the two companies had the right to adjust the controversy between the companies.

**(1). Plaintiff's construction of lease is incorrect.**

Plaintiff's claim is that under the terms of the lease from the Harlem Railroad Company to the New York Central and Hudson River Railroad Company, dated the first of April, 1873, the lessor company was entitled as matter of right, upon the maturity of the consolidated mortgage bonds of the lessor company to issue its new bonds secured by a new mortgage, in lieu of the consolidated bonds and mortgage, and that any saving in interest thereby effected would enure as

matter of right to the lessor company, while the lessee company would still be obliged to pay the equivalent of seven per cent. per annum upon the amount of the consolidated mortgage, in addition to the guaranteed dividends upon the stock of the Harlem Company, any excess of the seven per cent. per annum over the amount necessary to pay the interest on the new bonds enuring to the benefit of the Harlem stockholders *pro rata*. In other words, the claim is made that if the Harlem Company could refund the consolidated mortgage at three and one-half per cent., the Central Company would be bound to pay the three and one-half per cent. per annum to the bondholders by way of rental, and also to pay three and one-half per cent. to the stockholders of the Harlem Company in addition to their guaranteed dividend. This, we submit, is not a fair or reasonable construction of the terms of the lease. It is to be borne in mind in this connection that the lease from the Harlem Company did not include its street railroad in the City of New York, nor the building connected therewith. This circumstance has an important bearing upon the construction of the words in the lease to which we shall presently call attention. The rent to be paid under the lease is thus set forth, after the granting and *habendum* clauses of the lease.

“ FIRST. By paying to the several stockholders in the said party of the first part semi-annually, on each first day of July and first day of January, or whenever thereafter it shall be demanded, two dollars per share upon each share of its capital stock held by them respectively at the time of closing the transfer books, as hereinafter provided; such two dollars per share being equal to eight per centum per annum on the par value of such capital stock.”

“ SECOND. By paying the interest on the bonds of the said party of the first part as described in the Schedule hereto annexed, marked ‘ A,’ according to the conditions of said bonds respectively, and as such interest shall from time to time become due and payable and shall be demanded.”

It is to be noted, in this connection, that this is, on its face, a mere contract of indemnity so far as concerns the payment of interest on the bonds. The manifest object to be accomplished was that the stockholders of the Harlem Railroad should receive their 8 per cent. per annum upon their stock, free and clear of all incumbrances and liabilities, and for this purpose, the lessee company agrees in effect to indemnify and save harmless the Harlem Company from interest on its funded debt. This is the customary provision in railroad leases. The consideration moving to the stockholders for the lease is their guaranteed dividend. Provided this guaranteed dividend is paid at the times agreed upon, the stockholders under an ordinary railroad lease have no further interest in the management of the property, except that it shall be kept in good condition, and that all charges shall be taken care of by the lessee company. The lease further provides by the third clause of the article under consideration for the payment by the lessee company of "the rent agreed to be paid by the said party of the first part to the New York and Mahopac Railroad Company, according to the terms and conditions of the lease hereinbefore referred to." This clause is also clearly a mere contract of indemnity, so far as the stockholders are concerned.

That the relation of the two companies to the mortgage incumbrance was the ordinary relation of lessor and lessee company, in which the stockholders have no direct pecuniary interest other than to be indemnified against the principal and interest of the mortgage debt, is further manifest from the provisions of paragraph fourth, taken in connection with the provisions of paragraph first. Paragraph fourth recites:

"that the issue described in said Schedule as 'Consolidated Mortgage due May 1, 1900,' was duly authorized to be made for the amount of Twelve millions of dollars; that seven million four hundred and eighty-eight thousand dollars in amount of the bonds of the said issue remain

unsold, which bonds so unsold it agrees to deliver herewith to the party of the second part, to be disposed of by it as follows :

FIRST. By holding or selling *for its own use and benefit* such part thereof as shall at their par value equal the amount to be paid by the said party of the first part under the first and second subdivisions of the first article hereof, for proportions of dividend and interest accrued to the first day of April, one thousand eight hundred and seventy-three, and

“SECOND. By selling the remainder thereof *in its own discretion*, subject to the following conditions :

“FIRST. That the money derived by it from the sale of the whole or any part of such remainder shall be used in the same manner as is prescribed in the third article hereof with regard to moneys derived from the disposal of stock.

“SECOND. That whenever any bonds of such remainder shall be sold, the interest which shall thereafter become due and payable thereon shall be paid by the said party of the second part in addition to that on the amount of said bonds mentioned in said Schedule A, provided, however, as follows :

“FIRST. That this condition to pay interest shall apply also to the bonds that may be sold by the said party of the second part for its own use and benefit as hereinbefore authorized.

“SECOND. That the said party of the second part may issue any of the bonds of the said remainder in exchange or substitution for and upon the surrender for that purpose of any other of the outstanding bonds of the said party of the first part described in said Schedule.

“THIRD. That the title to any real estate acquired by the payment of moneys derived from disposing of the said capital stock under the third article hereof, or from the sale of any of

the bonds of said remainder under this article shall be taken to and in the name of the said party of the first part.

“FOURTH. That any and all of the property acquired with the moneys mentioned in the preceding proviso shall be deemed to be held by the said party of the second part under this contract, and subject to the provisions thereof.”

The reference in Sub-division First of the conditions above quoted to the third article of the lease, prescribing the use to be made of the moneys derived from disposing of stock, makes those provisions applicable to the proceeds of the sale of bonds, namely that the moneys so derived by the lessee company from the disposition of the stock or bonds shall be expended in improvements or equipments of the railroad, or in paying off or redeeming bonds of the lessor company, or in acquiring or perfecting title to real estate for the uses and purposes of the railroad, including the so-called Fourth avenue improvement. It will thus be seen that *carte blanche* is given to the lessee company to dispose of the unissued bonds under the consolidated mortgage at such price or prices as it may be able to obtain therefor, the only restriction being that the proceeds thereof shall be used in permanent betterments or improvements of the property of the lessor company.

The absolute discretion thus given by the lease to the lessee company is further emphasized by the following provisions of Article First :

“it being mutually covenanted and agreed that the payments made under this and the previous subdivision of Article First may be in the Consolidated Mortgage Bonds of the said party of the first part, hereinafter mentioned, which bonds so paid to the party of the second part may be used by it for its own sole and separate use and benefit.”

The two provisions above referred to are for payments to be made by the lessor company on or before the 30th day of June, 1873, to the lessee company, to adjust the first payments to be made by the lessee with reference to the date of the taking effect of the contract, the lessor company agreeing for this purpose to pay to the lessee company on or before the 30th day of June, 1873, one hundred and eighty thousand dollars, being equal to one dollar per share on the amount of its capital stock then outstanding, and equal to the part of eight per centum per annum thereon that would accrue between January 1, 1873, when the last dividend was paid thereon, and April 1st, 1873, when the contract took effect; and, also, in order to fairly adjust the first payment of interest to be made by the lessee on each kind of bonds mentioned in the schedule, with reference to the date of the taking effect of the lease, the lessor agreeing that it would, on or before the day on which the first interest shall become due and payable on any of the bonds described in the schedule, pay to the lessee company an amount equal to the amount of interest accrued, in each case, between the date of the last payment of interest on said bonds and the first day of April, 1873. It will be observed that the lessee company is given *carte blanche* to use the consolidated bonds which might be received in lieu of these payments from the lessor company "for its own sole and separate use and benefit," and absolutely without restriction as to the price to be received therefor.

Paragraph Fifth of the lease contains a covenant by the lessor company not to "authorize, create or issue any stock or bonds in addition to the amounts thereof respectively, now authorized or outstanding, as hereinbefore stated, except at the request or upon the demand of the said party of the second part, as hereinafter set forth; provided, however, that the said party of the second part may, at the request of the said party of the first part, and for purposes connected with the operating of the street railroad hereinafter mentioned, abate the covenant of the said party of the first part contained in this article; but such abatement shall be

entirely at the option of the said party of the second part as to granting at all, or as to the extent to be granted.

Thus far the lease is manifestly the ordinary railroad lease, known to all persons familiar with railroad matters. The stockholders are guaranteed eight per cent. per annum on their stock, and are indemnified against all charges and all current expenses of the operation of the road. They are also to receive the benefit, by way of permanent improvement to their property, of the proceeds of any of the stock and bonds thereafter issued and negotiated by the lessee company, except as above set forth.

The controversy, however, arises under the somewhat peculiar language of the next succeeding paragraph of the lease, namely, paragraph Sixth. For purposes of clearness in discussing this paragraph we shall take the liberty of substituting for the phrases "party of the first part" and "party of the second part" respectively the phrases "lessor" and "lessee." The paragraph begins by a covenant on the part of the lessee that it will pay the principal of all the bonds described in Schedule A, other than the consolidated mortgage bonds due May 1, 1900, as they shall respectively mature and be presented for payment. "And that it will, at the maturity thereof, pay the principal of the said 'Consolidated Mortgage' bonds, if and in case it should not be paid by the" lessor company. It is then provided that "in case of the *payment thereof or of some or any part thereof*" by the lessor company "then and in that event" the lessee company shall thereafter pay to the lessor company semi-annually, "on the days when interest would become due and payable on the said bonds if the time thereof had been *extended*, an amount equal to such interest on said bonds or on such part of them as may have been *paid* by the lessor company so as to fairly adjust the obligation" of the lessee company "as to the annual rent of the said railroad and property herein demised." Note that this language draws a clear distinction between "*payment*" and "*extension*." It clearly implies a distinction between

an actual payment which shall cancel either in whole or *pro tanto* the lien of the mortgage upon the railroad property on the one hand and a refunding or extension which shall continue the lien of the mortgage or its equivalent upon the *corpus* of the property. In this connection we again call attention to the fact that the lease does not cover all of the property of the railroad company; that it excludes its valuable street-surface lines running up from the City Hall through the Bowery and Fourth avenue and Madison avenue to the Harlem River, and the value of the real properties connected therewith and used for stables, &c., on Fourth avenue and Madison avenue. It was evidently contemplated that there might be a surplus in the treasury of the lessor company at the time of the maturity of the consolidated bonds, derived from the profits of the operation of the street-surface railroad, or derived from the sale of some of its real property, and that it might be deemed wise and prudent by the lessor company to apply this surplus to a retirement and cancellation of its consolidated mortgage bonds. In such event, it would be manifestly fair and right that, to the extent to which the assets of the lessor company had been taken from its treasury and applied to the reduction of its bonded debt, the lessor company should receive from the lessee company the equivalent of the annual interest upon the amount of the principal so retired and canceled. On the other hand, if there was no actual payment and cancellation, but simply a substitution of new bonds and a new mortgage for the exact amount of the old bonds and the old mortgage, then the situation of the parties, so far as the assets of the company were concerned, would remain substantially unchanged, and there would be no propriety in requiring the lessee company to pay to the lessor company interest on any portion of the bonded debt still remaining a lien on the property in the hands of the lessee. It is further to be observed that, under the fifth paragraph of the lease, the lessor company had no right or power to make a new

mortgage of any kind for the purpose of refunding, or for any other purpose, without the request or consent of the lessee company. It is provided by the Sixth paragraph that, "in case, however, the said 'Consolidated Mortgage' Bonds shall be paid by" the lessee company, the lessor company will, whenever requested by the lessee company so to do, "issue in lieu thereof new bonds bearing a similar rate of interest, or such other rate as may be agreed upon, with, so far as may be required, proper coupons or interest warrants therefor appended, and secured by a suitable mortgage upon the railroad property and franchises hereby demised; such bonds to be payable at such time or times and to such person or persons as may be prescribed by" the lessee company, "and will deliver such new bonds to" the lessee company "*to be sold or disposed of in its discretion; in which case the obligation of the lessee company herein contained with regard to the payment of interest on the said 'Consolidated Mortgage' Bonds shall be deemed and held to apply to interest on such new bonds.*"

It is perfectly plain that if this clause of the lease is the one under which the refunding of the Harlem Railroad indebtedness took place, any saving in interest enures to the benefit of the lessee company, and so much of the lease as provides for payment of interest on the old bonds is satisfied and discharged thereafter by payment of the interest on the new bonds, whether that interest be more or less than the interest on the old bonds. If, at the time of the maturity of the consolidated mortgage, the rate of interest, by reason of some great national catastrophe, or by the ordinary operations of the laws of trade and commerce had risen so that it was impossible to refund the indebtedness of the Harlem Company at seven per cent. and so that in order to avoid foreclosure of the mortgage, it was necessary to issue a new mortgage at ten per cent. it would surely have been then claimed by the Harlem Company that the lessee company was bound under the terms of the lease to pay such ten per cent.

per annum to the bondholders, and that the stockholders of the lessee company were in no respect bound to make good the excess of interest over the seven per cent. originally payable to the holders of the consolidated mortgage bonds. In like manner, if, by reason of the great prosperity of the country, and by reason of the operation of the laws of trade and commerce, the rate of interest had so far declined that at the date of the maturity of the consolidated mortgage, the lessee company was able to negotiate a loan at three and a half per cent. per annum, to take up and refund the consolidated mortgage, surely by parity of reason, the saving in interest thus effected would enure to the benefit of the lessee company, and not directly to the stockholders of the lessor company.

The only question is, therefore, does this particular clause of this paragraph of the lease apply to the situation as it stood at the date of the maturity of the consolidated mortgage, and was the refunding operation which was actually carried out to be considered as a payment by the lessee company or a payment by the lessor company? We say it was to be regarded as a payment by the lessee company. It is not averred in the complaint in this action that the Harlem Railroad Company had in its treasury at the date of the maturity of the consolidated mortgage, or prior thereto, the sum of twelve million dollars, which would have been necessary to pay off and cancel the lien of the mortgage. It does not therefore appear that the lessor company was in any position to exercise its option of paying the mortgage. It does appear that it was deemed necessary to keep alive the lien of the mortgage for that amount, by way of substitution of new bonds and a new mortgage for the outstanding bonds and mortgage. This was clearly the situation contemplated by the latter part of paragraph Sixth, above quoted, namely, the situation where the lessee company was entitled to call upon the lessor company for new bonds and a new mortgage, and out of the proceeds thereof, or out of its own funds in its own

treasury, to pay off the consolidated mortgage, and thereafter to indemnify and save harmless the lessor company from interest on the old bonds. This, we claim, was the true intent and meaning of this provision of the lease.

**(2) Construction of lease, at least, open to reasonable dispute.**

Even if the Court is of opinion that we are in error in thus construing the lease, it must at least be conceded that this construction is one which can be taken by a reasonably intelligent lawyer and is capable of being supported by plausible argument. It is certainly not so manifestly at variance with the plain language of the instrument that two reasonably intelligent lawyers could not honestly differ with regard to it.

If this be the case, there was a fair occasion for compromise and adjustment.

**(3) Directors had right to make compromise of disputed questions.**

**Ratification by stockholders not necessary.**

An agreement to relinquish a supposed claim is a sufficient consideration for promise. Not necessary that claim relinquished be a valid one, enforceable at law. It is enough that party making it has some ground for believing that the liability exists.

*Dovale vs. Ackerman*, 11 Misc., 245.

*White vs. Hoyt*, 73 N. Y., 505-514.

*Wahl vs. Barnum*, 116 N. Y., 87.

*Zoebisck vs. Van Minden*, 120 N. Y., 407.

As to power of directors to act without authority from or ratification by stockholders, see

*Beveridge vs. N. Y. Elevated R. R. Co.*, 112 N. Y., 1.

V. The allegations of the complaint as to stockholders of Harlem company being interested in Cen-

tral company must be disregarded as wholly immaterial. It is perfectly well settled that stockholders of a corporation are not disqualified to vote on a proposition to ratify a contract of the Board of Directors because of personal interest in such contract.

(See *Gamble vs. Queens County Water Co.*, 123 N. Y., 91; *Transportation Co. vs. Beatty*, L. R., 12 App. Cases, 589; *Bjorngaard vs. Goodhue Co. Bank*, 49 Minn., 483; 52 N. W. Rep., 48; *Burland vs. Earle*, Privy Council, Nov., 1901; Ap. Cases, 1902, Vol. 1, p. 83).

Stockholders may vote upon a resolution to discontinue an action brought in the name of the corporation, although they are interested in the result.

*Socorro Mountain Mining Co. vs. Preston*,  
17 Misc., 220.

The latest expression of judicial opinion on this subject, which has come to our attention, is in the two cases of *Windmuller vs. Standard Distilling and Distributing Company*, 114 Fed. Rep., 491 and 115 Fed. Rep., 748. The former decision was made by Judge KIRKPATRICK, in the United States Circuit Court for the District of New Jersey, on the 12th of March, 1902. The learned Judge says, at (p. 494) :

“ I have not here referred to any authority which  
 “ holds that one stockholder is in any sense a  
 “ trustee for other stockholders, or that he is  
 “ deprived from voting on his stock according to  
 “ what he may conceive to be his interest, or in  
 “ a way which may result in a benefit to himself  
 “ and which other stockholders may not enjoy.  
 “ Directors, by whomsoever elected, are the  
 “ representatives of all the stockholders and as  
 “ such are charged with the duty of administering  
 “ the affairs of the company for the equal benefit  
 “ of their *cestuis que trustent*. But the doctrine is  
 “ new that the stockholders are trustees one for  
 “ another, or that an interest of one stockholder  
 “ which, in the judgment of another stockholder,

“ may seem to be adverse to his own, can operate  
 “ to prevent him from voting on his own stock as  
 “ he sees fit. \* \* \* No case has been brought  
 “ to the attention of the Court where any stock-  
 “ holder has been deprived of his right to vote on  
 “ his stock in such a way as may, in his opinion,  
 “ best subserve his own interests.”

The Court approves and follows the cases of *Transportation Company vs. Beatty*, and *Gamble vs. Queens County Water Company*, cited *supra*.

The second *Windmuller* case was decided by Circuit Judge LACOMBE, in the Circuit Court of the United States for the Southern District of New York, on April 1, 1902; and it was held by Judge LACOMBE, that

“ A stockholder in a corporation has the right to  
 “ vote for its dissolution, even though he is in-  
 “ fluenced to that course by a wish to terminate a  
 “ contract beneficial to the corporation but onerous  
 “ to himself.”

Judge LACOMBE follows the decision of Judge KIRKPATRICK, above quoted.

VI. It may be claimed, however, that the complaint sets forth a case of actual fraud and bad faith on the part of the directors of the Harlem Company sufficient to justify equitable relief. We insist, however, that no such case is alleged.

Boiled down and stripped of verbiage, the claim of fraud is based upon allegations that certain of the directors of the Harlem Company and certain “ favored stockholders ” of that company were interested in a syndicate which made profits upon the sale of the bonds and that the commission agreed to be paid to J. P. Morgan & Company and J. S. Morgan & Com-

pany for purchasing the bonds was excessive and the price at which the bonds were sold was very much below their then market value.

Of course, for the purposes of this motion, we must assume these allegations to be true, although not borne out by the facts as stipulated. Assuming them, however, to be true, how do they show or even tend to show that the compromise agreement was fraudulent?

It appears that the new mortgage of the Harlem Company was executed and delivered to the Guaranty Trust Company of New York, on the 1st of June, 1897.

The contract with J. P. Morgan & Co. and J. S. Morgan & Co. for the sale to them of the bonds secured by said mortgage is alleged in the complaint to have been made by the Harlem Company on the 8th of June, 1897. There is no pretense that the second supplemental contract was then in contemplation, or that its subsequent execution was in any way connected with or caused by the contract with the Morgan firms made more than a year before.

All that is claimed is that "the said second supplementary contract contains a proviso that nothing therein contained is intended to or shall be construed to interfere with the execution and delivery of the bonds of the Harlem Company as provided in and by its said mortgage to the Guaranty Trust Company of New York, dated June 1, 1897, and the contract for the sale of the bonds to be issued thereunder."

This merely stated a legal proposition as to a contract made in the previous year. So far as this involved a ratification and affirmance of that contract it was perfectly just and fair. The contract was made by the Harlem Company at a time when the board of directors was acting in hostility to the claim of the board of directors of the Central Company as to the construction of the lease. The commission then agreed upon by the directors of the Harlem Company was, therefore, in no respect a consideration for the subsequent compromise agreement. That the commission was considered a fair one is evidenced by the fact that a precisely similar commission was agreed to be paid

to the Morgan firms by the Central Company for the purchase of the new three and one-half per cent. bonds to be issued by that company for refunding the obligations of that company.

A theory seems to be in the mind of the pleader that the vote of certain directors of the Harlem Company in favor of the compromise agreement was influenced by the fact that they were interested in the commissions or profits to be derived by the Morgan firms from the sale of the bonds. That interest, however, was neither increased nor diminished by the compromise agreement. On the contrary, if the compromise agreement had never been made, and if the contention of the Harlem Company had prevailed to its fullest extent, the contract between the Harlem Company and the Morgan firms would have still been in full force and effect.

The compromise agreement did not create or validate that contract. The utmost that can be claimed is that it waived any objections to that contract on the part of the stockholders. If the contract itself is wrongful, then it was wrongful when made, and did not become wrongful by reason of the compromise agreement.

To avoid confusion it must be noted that J. P. Morgan, when the contract was made, was not a director of the Harlem Company. He was a director of the Central Company, but no claim is made by that company or by any stockholder thereof that the contract between that company and the Morgan firms was unfair or fraudulent.

The whole question as to the price at which the Harlem bonds were sold or the profits made by any syndicate thereon is wholly collateral to and irrelevant to the question of the fairness or validity of the compromise agreement between the two companies, and furnishes no basis whatever for setting aside that agreement.

The complaint contains statements to the effect that the stockholders who voted at the stockholders' meeting of the New York and Harlem Railroad Com-

pany, which ratified the so-called second amendatory contract, that is to say, the compromise agreement, were not fully informed of the nature of the contract with J. P. Morgan & Company and J. S. Morgan & Company with regard to the terms of the sale of the new bonds and with regard to the parties interested in the profits of said sale; and that so far as the stockholders undertook to ratify or may be considered to have ratified that contract, they did so in ignorance of the real nature and effect of the contract. The claim of the plaintiff seems to be that the action of the stockholders' meeting should, therefore, be disregarded not only as a ratification of the contract with the Morgan firms for the sale of the bonds, but also so far as it ratified the compromise agreement. This is a clear *non sequitur*. The ratification of the compromise agreement is quite apart from the ratification of the agreement for the sale of the bonds. The two agreements were not mutually inter-dependent, nor even contemporaneous, as we have already pointed out.

Assuming, however, that there is any basis for the claim that the stockholders acted without full information so far as they ratified or undertook to ratify the contract with the Morgan firms, surely this is a matter which can be taken advantage of only by such stockholders as were in fact misled. It is not claimed by the plaintiff that the plaintiff was misled or that any of the other stockholders who are interested in this litigation together with the plaintiff were misled. They could not have been misled to their injury, for they are not alleged to have voted in favor of the proposition submitted. No stockholder who did so vote has been heard to complain that he voted in favor of the resolutions of ratification in ignorance of any of the essential facts, or that he gave his proxy in ignorance of any of the essential facts, or that his proxy exceeded the authority intended to be committed to him. If any stockholder desires to repudiate the action taken in his name at a stockholders' meeting, he alone can so repudiate it. Not only that, but he must act promptly. Not only that, but he is pre-

sumed to know the facts which he could have ascertained with reasonable diligence.

This subject has been recently discussed by the United States Circuit Court of Appeals for the Sixth Circuit, in the case of *Synnott vs. Cumberland Building Loan Association*, 117 Fed. Rep., 379, where the Court held that a stockholder is bound by the action of his proxy at a stockholders' meeting, unless he exercises the most active diligence in repudiating the same; that

“ A stockholder is bound by the action of his  
“ proxy at a stockholders' meeting, unless he ex-  
“ ercises the most active diligence in repudiating  
“ the same and is chargeable with such knowledge  
“ of what was done at the meeting as he ought to  
“ have obtained and would have obtained in the  
“ exercise of reasonable diligence and care with  
“ respect to his business and property rights. A  
“ delay of more than a year before taking any  
“ steps to repudiate the action of his proxy, if  
“ unexcused, is such laches as will debar a stock-  
“ holder from the right to relief.”

VII. The only other question raised by the complaint is as to the effect of the first supplemental contract as tying the hands of the Harlem Company's directors or stockholders.

It will doubtless be claimed on behalf of plaintiff that this first supplemental contract dated May 15th, 1882, had the effect of prohibiting the modification of the terms of the lease as provided by the second supplemental contract of 1898, without the unanimous consent of the stockholders of the Harlem Company.

This first supplemental contract is made a part of the complaint as Exhibit “B.”

It provided that the first and second articles of the lease of April 1st, 1873, shall not be changed or amended by any action of the directors or stockholders of the parties to the lease or either of them; and that the annual rent reserved by and to be paid under the

said first and second articles, shall be paid during the whole term of the lease and at the times and in the manner therein provided, notwithstanding any future action of the directors or stockholders of the parties or of either of them.

No mention is made in this agreement of the sixth article of the lease. The first and second articles are specifically mentioned, and are the only articles mentioned. On the principle of *expressio unius, exclusio alterius*, it follows that every other article except the first and second articles can be amended by the directors or by the stockholders, including the sixth article. The second supplemental contract amends only the sixth article as to the payment or refunding of the consolidated mortgage and the effect thereof. It in no respect affects the provisions for eight per cent. dividend to stockholders or for payment of interest on the bonded indebtedness, or of the rent of the Mahopac road, provided for in the first and second articles of the lease.

Nor does the second supplemental contract in any way interfere with the payment of the annual rent by and to be paid under the said *first and second articles* during the whole term of the lease at the times and in the manner therein provided.

The most that it accomplishes is to change or abrogate the payments required to be made by the sixth article, which article is in no way referred to or embraced within the provisions of the first and second articles.

WM. B. HORNBLOWER,  
Of Counsel for Defendants.



























## Supreme Court.

THE CONTINENTAL INSURANCE  
COMPANY and others,  
Plaintiffs,

AGAINST

THE NEW YORK AND HARLEM  
RAILROAD COMPANY and THE  
NEW YORK CENTRAL AND  
HUDSON RIVER RAILROAD  
COMPANY,  
Defendants.

### BRIEF IN OPPOSITION TO MOTION TO DIS- MISS THE COMPLAINT.

#### Statement.

This is a motion to dismiss the complaint on the ground that it does not state facts sufficient to constitute a cause of action.

The purpose and object of the action out, as indicated by the allegations of the complaint and the prayer for relief, is to set aside and adjudge void a second supplementary contract amending a lease between the New York and Harlem Railroad Company (hereinafter called the Harlem Company) and the New York Central and Hudson River Railroad Company (hereinafter called the Central Company) by reducing the rent payable by the Central Com-

pany to the Harlem Company in the sum of \$220,000 a year for the unexpired term of the lease, after May 1, 1900, making a total reduction of rent of upwards of \$82,200,000. The allegations of the complaint material to the consideration of this motion, and admitted by the demurrer, establish the following

### **Facts.**

On the first of April, 1873, the Harlem Company leased to the Central Company certain of its railroad and property for the full term of four hundred and one years from the first day of April, eighteen hundred and seventy-three (Complaint, pp. 25, 26, 27, fols. 73-82).

In addition to the grant of the use of the demised premises the Harlem Company issued to the Central Company 20,000 shares of its capital stock of the par value of fifty dollars each, amounting to \$1,000,000 (Complaint, p. 30, fol. 90). Also consolidated mortgage bonds of the amount of \$7,488,000 (Complaint, p. 31, fol. 93), the proceeds of which were to be used by the Central Company in the improvement of the demised properties.

The lease also assigns to the Central Company all right, title and interest in the lease of a certain block of ground bounded by White, Centre, Franklin and Elm streets, in the City of New York (Complaint, p. 37, fols. 111, 113). The lease further grants to the Central Company the right to use the tracks of its street railroad south of Forty-second street, so far as may be necessary to hauling the freight cars that the Central Company may use in connection with business or traffic on the demised railroad, to the freight depot on White, Centre, Franklin and Elm streets (Complaint, p. 38, fol. 114).

Article twenty-third of the lease, after reciting that the rents, reservations, &c., herein contained have been adjusted and fixed as hereinbefore set

forth with express reference to the provisions contained in this article, provides for the conveyance in fee by the Harlem Company to the Central Company of the valuable real estate mentioned in Schedule "D" annexed to the lease (Complaint, p. 49, fol. 147; Schedule "D," p. 57).

By article twenty-fourth of the lease (Complaint, 50, fol. 149), the bonds and mortgages described in Schedule "E" annexed to the lease, amounting to \$182,818.53, are assigned to the Central Company (Schedule "E," p. 59).

By article twenty-fifth of the lease, all the stock of the New York and Mahopac Railroad Company amounting at par to \$265,000, is transferred to the Central Company (Complaint, p. 50, fols. 150-151).

At the date of the lease the authorized capital stock of the Harlem Company was \$10,000,000 divided into 200,000 shares of the par value of \$50 each all of which was issued and outstanding for more than five years prior to the commencement of this action (Complaint, p. 3, fol. 7). At the same date the Harlem Company had duly authorized the issue of consolidated mortgage bonds to the aggregate amount of \$12,000,000, all of which were issued and outstanding for a number of years prior to the year 1896 (Complaint, p. 3, fol. 9).

The annual rent reserved to the Harlem Company by Article First of the lease, and covenanted to be paid by the Central Company by Article Second of the lease, was the sum of \$1,640,000, being the equivalent of 8 per cent. on the \$10,000,000 of capital stock and seven per cent. on \$12,000,000 of consolidated mortgage bonds (Complaint, pp. 28-31, fols. 82-91).

On the 15th of May, 1882, the Harlem and Central companies entered into a contract, in writing, supplemental to the lease, providing that the First and Second articles of the lease of 1873 fixing the amount of rent should not be changed or amended by any action of the directors of the

parties or either of them or by any action of the stockholders, and that the *annual rent* reserved by and under the First and Second articles of the contract of April 1, 1873, should be paid during the whole term of the contract, at the time and in the manner therein provided, notwithstanding any *future* action of the directors of the parties hereto or either of them or of the stockholders thereof, and giving a right of action to any stockholder to enforce the payment of such rent to the extent of his proportionate part thereof; using if needful the name of the Harlem Company (Complaint, p. 4, fols. 12-14; p. 60, fols. 179-182).

This supplementary contract of May 15, 1882, was duly approved by the stockholders of the Central and Harlem companies by the unanimous vote of the stock voted (Complaint, p. 5, fol. 15).

Since the execution and delivery of the lease the rental value of the railroad and property therein demised has greatly increased. The Central Company derives large revenues from the demised property and is and will be abundantly able to pay the rent reserved in the lease and will, after May 1, 1900, continue to pay the rent which it has heretofore and now pays during the unexpired term of the lease rather than terminate the lease and surrender the use and occupation of said demised property, and such rent, with the other amounts agreed in and by the lease to be paid by the Central Company as its annual rent, will be no more than it has been paying for a number of years past (Complaint, p. 10, fols. 30-31).

The lease, in anticipation of the maturity of the Consolidated Mortgage Bonds amounting to \$12,000,000 to the payment of the interest on which \$840,000 of the rent reserved was by the terms of the lease applied, provides in its Sixth Article (Complaint, p. 33, fols. 98-99) that in case of the payment of the consolidated mortgage bonds or some or any part thereof by the Harlem Company, the Central Company would thereafter pay to the Harlem Company on the days

when interest would become due and payable on said bonds, if the time thereof had been extended, *an amount equal to such interest on said bonds*, or such part of them as may have been paid by the Harlem Company, *so as fairly to adjust the obligation* of the Central Company herein contained as to the *annual rent* on the said railroad and property herein demised (Complaint, p. 33, fol. 99).

On or shortly before April 14, 1897, the Harlem Company was advised by its counsel that it was the right and duty of the Harlem Company to pay the Consolidated Mortgage Bonds of \$12,000,000 upon their maturity, and in accordance with such advice and in the exercise of such right and in the performance of such duty, the directors of the Harlem Company, at a meeting held on April 14, 1897, *unanimously* adopted preambles and resolutions asserting its right to pay off the bonds and its ability to provide the money for that purpose by the issue of new bonds bearing interest at the rate of three and one-half per cent. per annum and asserting its right after the payment of the Consolidated Mortgage Bonds to receive from the Central Company an amount equal to seven per cent. on the \$12,000,000, as if the time of the consolidated mortgage bonds had been extended, out of which rent it would be able to pay the interest on the new bonds and reserve for its corporate purposes the annual sum of \$420,000. Thereupon resolutions were adopted authorizing the execution and delivery of a new first mortgage to secure a new issue of bonds, bearing interest at the rate of  $3\frac{1}{2}$  per cent., for the aggregate principal sum of \$12,000,000, and directing a special meeting of the stockholders of the Harlem Company to be called for the purpose of giving their consent thereto

The preambles and resolutions each provided that it should be an essential condition of the issue of every such new mortgage that the bonds issued thereunder should only be issued to provide for the payment of at least an equal amount of Consolidated

Mortgage Bonds, so that at no time shall there be authorized, issued and outstanding more than \$12,000,000, principal of the bonds of the Harlem Company, including the principal of all outstanding and unpaid Consolidated Mortgage Bonds (Complaint, p. 6, fols. 17-25).

On May 27, 1897, the issue of the new first mortgage bonds upon the terms and subject to the conditions imposed, was duly approved by the stockholders of the Harlem Company (Complaint, p. 9, fol. 28).

On or about the first of June, 1897, the Harlem Company duly executed a mortgage to the Guaranty Trust Company of New York, as trustee, the mortgage providing that all the bonds to be issued thereunder should be used exclusively for the simultaneous payment and satisfaction from time to time of at least an equal amount of Consolidated Mortgage Bonds, so as not to increase the amount of the bonded indebtedness of the Harlem Company at any time outstanding. *The mortgage is also made subject to the lease of the Harlem Company to the Central Company* (Complaint, p. 10, fols. 29-30).

At the date of the execution of this mortgage the stock of the Harlem Company was selling in the open market at the rate of three hundred per cent. of the par value thereof and the property of the company as indicated by that selling price was worth upwards of \$40,000,000 (Complaint, p. 11, fols. 32-33).

By the issue of the new bonds and the payment of the Consolidated Mortgage Bonds in the manner proposed, the Harlem Company would increase its annual income after May 1, 1900, by the sum of \$420,000, enabling it to increase its annual dividend to stockholders after May 1, 1900, by the amount of four and two-tenths per cent. (Complaint, p. 11, fol. 33).

*Prior to the year 1896, and continuously since, a majority of the Board of Directors of the Cen-*

*tral Company also constituted a majority of the Board of Directors of the Harlem Company and such majority owned or controlled a majority of the stock of both companies and dominated the policy and controlled the management of each company and the selection of officers and directors thereof and the financial interests of said controlling and majority directors were during said period and now are much larger in the Central Company than in the Harlem Company. (Complaint, p. 12, fol. 35.)*

On April 8, 1897, J. P. Morgan & Co., and J. S. Morgan & Co., entered into a contract with the Harlem Company to purchase the entire issue of \$12,000,000 of new first mortgage bonds at a premium of three and one-half per cent. in consideration of the payment to them by the Harlem Company of a commission of three and one half per cent., which commission amounted in the aggregate, to the sum of \$420,000. J. P. Morgan, of the firm of Morgan & Co., was a director of the Central Company and a stockholder of the Harlem Company (Complaint, p. 19, fol. 56). The purchasers of the Harlem bonds represented and associated with themselves a syndicate composed in part of certain *avored* stockholders of the Harlem Company and certain of the directors of the Harlem Company were also members of or interested in said syndicate (Complaint, p. 19, fol. 56). The commission of \$420,000 agreed to be paid to the purchasers of the bonds is hundreds of thousands of dollars in excess of the commission for which responsible bankers would have undertaken the sale of the bonds. (Complaint, p. 19, fol. 56.) The price at which the bonds were sold was very much below their market value. Upon the issue of the bonds the syndicate sold the bonds to another syndicate at a premium of eight and one-half per cent., securing a profit of \$960,000. The second syndicate sold the bonds at a premium

of upwards of fifteen per cent., securing a profit over the price received by the Harlem Company of \$1,800,000. Had the bonds been offered to the Harlem Company's stockholders at par with privilege of assigning their right to subscribe for the same, every penny of profit that was realized by the purchasers and syndicate by way of premium could have been realized by the Harlem's stockholders (Complaint pp. 19-20, fols. 57-58).

At the same date that the Harlem Company was about to issue its new first mortgage bonds, the Central Company, *a majority of whose directors were also a majority of the directors of the Harlem Company*, entered into a contract with the firms of J. P. Morgan & Co., and J. S. Morgan & Co., and sold to them bonds about to be issued, by the Central Company, of the face value of \$85,000,000, having one hundred years to run and bearing interest at the rate of three and one-half per cent. per annum, at a premium of three and one-half per cent. J. P. Morgan was a member of each of these firms and a director of the Central Company. The contract of sale provided that the Central Company should pay the purchasers a commission of \$2,975,000, being millions of dollars in excess of a just, fair and reasonable commission. The price at which the bonds were sold was millions of dollars less than the fair market value thereof (Complaint, p. 20, fols. 59-60).

The purchasers of the Central Company's bonds associated with themselves a syndicate composed in part of directors and stockholders of the Harlem Company, have sold and disposed of the Central Company's bonds at a premium of upwards of nine per cent., thereby securing to the purchasers and the syndicate a profit of upwards of \$7,650,000 (Complaint, p. 21, fol. 61).

Upon the completion of the purchase of the Central and Harlem Company's bonds by Morgan and the associated syndicate, composed of Central Company directors and stockholders and favored Harlem Company directors and stockholders, and on or

about June 22, 1898, certain preambles and resolutions were adopted by the Central Company, which recited that the Central Company had instituted and was prosecuting in the Supreme Court, in the State of New York, an action to enjoin the Harlem Company from the issue and negotiation of the new first mortgage bonds. The resolution appointed a committee of three of the directors of the Central Company with power to negotiate and make a settlement with the Harlem Company of the matters in controversy in said action (Complaint, p. 12, fol. 36).

On the 28th of June, 1898, a like committee of three was appointed by the Harlem Company to make a settlement of the action. The action was a suit commenced by the Central Company against the Harlem Company by the service of a summons on the 29th of June, 1897. The complaint in the action *untruthfully* alleged that the issue of the new first mortgage bonds would increase the bonded indebtedness of the Harlem Company beyond \$12,000,000 (Complaint, p. 13, fol. 39). The complaint also *untruthfully* alleged that the Harlem Company had not the means to pay in cash the consolidated mortgage bonds at maturity and had no means of retiring and paying them except by the issue of said mortgage to the Guaranty Trust Company of New York (Complaint, p. 13, fol. 39).

The *untruthfulness* of these allegations *was well known to the Central Company, its officers and Board of Directors* (Complaint, p. 14, fol. 40).

The Harlem Company was advised that it had a good and sufficient defense to the action and promptly interposed an answer putting in issue each and every material allegation of the complaint.

The action of the Central Company against the Harlem Company was *not instituted in good faith or for the purpose, or with the intent of prosecuting the same to judgment, and was only commenced for the purpose of discontinuing the same, and thereby furnishing a colorable excuse or pretense of con-*

*sideration for the said so-called compromise and second supplementary contract* (Complaint, p. 15, fol. 45).

On August 10, 1898, upon motion of J. P. Morgan, a director of the Central Company and a member of the syndicate, resolutions were adopted at a meeting of the joint committees above mentioned approving the execution by the two companies of the second supplementary contract, by the terms whereof the Central Company is *released* and *discharged* from its obligation to pay, after May 1, 1900, the sum of \$220,000 per year, amounting in the aggregate to upwards of \$82,200,000, without addition of interest (Complaint, p. 14, fols. 42-42).

Immediately after the meeting of August 10, 1898, the directors of the Harlem Company caused to be sent to the stockholders of that company a partial and misleading circular not fully or fairly setting forth the facts with respect to the second supplementary contract. The circular failed to disclose the fact that the second supplementary contract contained the proviso that nothing herein contained is intended to or shall be construed to interfere with the execution and delivery of the bonds of the Harlem Company as provided in and by its said mortgage to the Guaranty Trust Company of New York, dated June 1, 1897, *and the contract for the sale of the bonds to be issued thereunder.*

The circular also failed to set forth or state the fact that certain favored stockholders of the Harlem Company and certain of its directors were interested in the contract for the sale of bonds mentioned and referred to in said second supplementary contract (Complaint, p. 15, fols. 43-44; p. 19, fols. 55-56).

At or about the same date the Central Company issued a circular to its stockholders which, referring to the second supplementary contract, stated: "Under its provisions a *SAVING* of over \$200,000 per annum *in fixed charges* will be effected by the New

York Central and Hudson River Railroad Company."

On the 28th of September, 1898, Thomas Hitchcock, a stockholder of the Harlem Company, commenced an action in his own behalf and in behalf of all other stockholders to restrain the Harlem Company and the directors thereof and also the Central Company from entering into the proposed second supplementary contract and issue was joined in the action. This plaintiff was advised that said action would be prosecuted to judgment and the rights of the Harlem Company and its stockholders under the lease would be adjudged and determined therein and that the second supplementary contract would not be executed until such rights should be so determined (Complaint, p. 16, fols. 47-48).

On the 5th day of April, 1900, without knowledge of plaintiffs, by procurement and with privity of the Harlem Company and its officers and directors or some of them, a large sum of money or the equivalent thereof was paid to said Hitchcock, and a discontinuance of his action was obtained, just as it was about to come to trial. Upon the same date the action brought by the Central Company was discontinued; thereupon the second supplementary contract was executed, delivered and exchanged, the new bonds of the Harlem Company were issued under and in accordance with the terms of the new first mortgage and said bonds sold in the open market at  $115\frac{82}{100}$  per cent. of the par value thereof and accrued interest (Complaint, p. 17, fols. 49-50).

By the terms of the second supplementary contract, although the Harlem Company is required to pay the consolidated mortgage bonds, the Central Company is released from its obligation to pay rent in the amount of upwards of \$82,200,000 (Complaint, p. 17, fols. 51-52).

The Harlem Company agrees to and does surrender its corporate power to increase its capital stock or to borrow money no matter how great the

exigency or pressing the emergency calling for the exercise of such power (Complaint, p. 18, fol. 53.)

The Harlem Company surrenders its right under the lease of 1873 to control the rate of interest on new bonds to be issued and agrees that the Central Company may fix the rate of interest.

The Harlem Company surrenders to the Central Company the right to fix the term of any new bonds that it shall issue and the price at which they shall be disposed of and the time of such disposition (Complaint, p. 19, fol. 54).

The second supplementary contract which is not founded upon any good, valuable, equitable or other consideration (Complaint, p. 21, fol. 63), gives to the Central Company upwards of \$82,200,000; violates the rights and sacrifices the interests of the Harlem Company and its stockholders to their great and irreparable damage and injury (Complaint, p. 21, fols 63-64).

The proviso in the second supplementary contract affirming and ratifying the sale of the bonds of the Harlem Company was not inserted therein in the interest of the Harlem Company or of its stockholders, but solely in the interest of the purchasers of such bonds, and such of the favored directors and stockholders of the Harlem Company as were fortunate enough to be members of or interested in the syndicate, and was against the interests of the Harlem Company, and each and every of the covenants, stipulations and agreements contained in said Second Supplementary contract were in the interest of and were intended to be in the interest of the Central Company and not in the interest of but against the interest of the Harlem Company (Complaint, p. 21, fol. 62).

The authorization, execution and delivery of said second supplementary contract by the officers and directors of the Harlem Company was and is against the interests of the Harlem Company and its stockholders and was intended by said directors and each of them to be and was in the interest of the Central

Company, a majority of the directors of which were and are, also a majority of the directors of the Harlem Company (Complaint, p. 22, fol. 65).

*The second supplementary contract and the execution thereof was authorized and approved by the vote of directors of the Central Company, who at the same time were directors of the Harlem Company, and by votes of certain of the directors of the Harlem Company who were interested in the contract for the purchase of the bonds of the Harlem Company mentioned in said Second Supplementary Contract, and who were also interested in the purchase of the bonds of the Central Company, and at the date of the authorization and approval of the Second Supplementary Contract, a majority of the directors of the Harlem Company constituted a majority of the directors of the Central Company and dominated and controlled its policy and management* (Complaint, p. 16, fol. 46).

The plaintiff on April 30, 1900, served on the Harlem Company and its directors a demand that this action or one having the same object should be brought (Complaint, pp. 22, 23) (see copy of demand, Complaint, p. 63). The Harlem Company, of course, did not do it (Complaint, p. 23). The action was brought on June 27, 1900 (see Summons, p. 1, and Verification of Complaint, p. 24). It does not appear that any action was taken by the Central Company under the Second Supplementary contract before this suit was brought.

It is upon the foregoing admitted facts and the just inferences properly deducible therefrom that the plaintiffs in this action, representing upwards of 5,000 shares of the capital stock of the Harlem Company, insist upon the sufficiency of the complaint.

## POINT I.

**The construction of the lease as claimed by the Harlem Company is the correct one.**

It is claimed by that company that the annual rent mentioned in the first and second articles of the lease included not only the eight per cent. dividend on the stock of the corporation, but also the interest on the consolidated mortgage bonds agreed to be paid by the first and second articles. The Central Company, on the contrary, claims that this interest was no part of the annual rent, but was a mere indemnity from the payment of which it was to be relieved whenever the mortgage was cancelled. Which of these two constructions is the proper one is the question which lies at the foundation of this action.

(1.) Before proceeding to the examination of the terms of the lease it is well to consider the situation of the parties; the nature of the property leased, and the effect of the two constructions.

By the terms of this lease not only did the Central Railroad come into possession as lessee for the term of something over four hundred years of the Harlem Railroad and all its appurtenances and stations, including the Grand Central Station, but there was actually transferred to it stock of the road to the par value of \$1,000,000, consolidated mortgage bonds to the value of \$7,488,000, and bonds and mortgages valued at over \$482,000, total \$8,890,000. In addition to that there was conveyed to the Central Railroad a large amount of real estate, the value of which does not appear, but it was undoubtedly very great. Besides that it obtained the right to use the horse railroad of the Harlem road for certain purposes, and the lease of the Harlem road to the New Haven road, the value of which must have been

considerable. All of this property was actually turned over to the Central Railroad Company. To offset that property, it assumed the payment of \$3,168,000 of bonds of the Harlem road which were to fall due, and in addition the obligation of the Harlem road to pay for work on the Fourth avenue improvement, which was estimated at \$5,803,000, but one-half of which was to be paid by the City of New York, so that the net results to the Harlem road, in addition to the lease, were that it obtained about \$2,000,000 of valuable assets, which it owned and went absolutely to the benefit of the Central Company itself. In addition to that the Central Company, having agreed to pay the rent of the Mahopac Railroad, received all the stock and bonds of that road, valued at something over \$265,000 (Complt., p. 50, fol. 150), so that the agreement to pay the rent of the Mahopac Railroad was simply an agreement to pay to itself the amount of that rental. The property thus transferred by the lease was continually advancing in value, and it must have been expected by the parties that it would continue to do so. The sum to be paid was evidently considered by the parties at the time of making the lease, as a proper amount of rent for the property thus demised and sold.

Under the construction of the plaintiff, the amount of rent to be paid by the Central and received by the Harlem would never vary. It was \$1,640,000, to be paid by the Central by paying *to or on account of* the Harlem Road an annual rent, to be paid as follows: First, by paying to the stockholders of the Harlem two dollars per share upon each share of capital stock. This payment was to be made direct, as will be seen, to the stockholders, and amounted to \$800,000 per annum. Second, by paying the interest on the consolidated mortgage of the Harlem, which amounted at that time to \$840,000 per annum. The lease does not specify that this interest is to be paid to the bondholders. Under the foregoing provision—that the rent is to

be paid *to or on account of* the Harlem road—it is clear that the Central Road had the option to pay it either to the Harlem or to its bondholders, if it deemed it necessary for its own protection, to insure it against risks of foreclosure. But it was not obligated to pay it to the bondholders, and might pay it direct to the Harlem.

Under the construction claimed by the defendant, the rent would remain the same if the Harlem road borrowed the money to pay off the existing bonds at an equal or increased rate of interest, while the rent would be reduced if the Harlem road borrowed the money at a reduced rate of interest; that is, that under no circumstances could the Harlem road be benefited, and under the contingency of its being able, by reason of its own increased credit or resources, to borrow money to pay off its own debt at a less rate of interest, that the lessee, who in no manner contributed towards such payment or such reduction of interest, should receive the entire benefit thereof. Under no circumstances was the landlord to be benefited, and under certain circumstances, beyond the control of the tenant, he was to be benefited and the landlord damnified. It is clear that such a construction of the lease would not be adopted unless its language imperatively required it. The construction claimed by the plaintiff—that the rent was always to be the same—is reasonable. The amount of rent was not originally fixed with reference to the amount of incumbrances, or the amount of interest which the landlord had to pay, or the amount of money which the landlord owed, but it was fixed with reference to the value of the property. The tenant was willing to pay \$1,640,000 for the property which it got. When the consolidated mortgages were paid off, the tenant still had the same property, and its value to him was the same. It is not an answer to this to say that its value to the landlord was increased by the reduced rate of interest, because such interest forms no part of the property. It is interest on

a debt of the landlord, for which the property is merely collateral security. There is no conceivable reason why the rent should vary by reason of any change in the rate of interest. Especially is this the case when it is considered that by the terms of the lease, if new bonds are issued, that when they fall due the process for their payment shall be repeated as often as may be necessary during the continuance of the contract—four hundred years. So that under the defendant's construction, during four hundred years the rent to be paid by it might be diminished from time to time, and could never be increased, and the landlord might be compelled to pay more interest from time to time, but could never get it back.

(2.) The interest on the consolidated mortgage bonds of the Harlem Railroad was a portion of the annual rent agreed to be paid. The express provision of Article First of the lease was as follows:

“Yielding or paying therefor to or on account of the said party of the first part during the continuance of the said demised term an annual rent to be paid as follows:

FIRST.—By paying to the stockholders in the said party of the first part semi-annually \$2.00 a share on each share of its capital stock, being equal to eight per cent. per annum on the par value of such capital stock.

SECOND.—By paying the interest on the bonds of the said party of the first part described in the schedule hereto annexed marked 'A,' according to the conditions of said bonds respectively, and as such interest shall from time to time become due and payable and be demanded.”

The second article of the lease contained an express covenant on the part of the Central Railroad to make the payments prescribed in the said first article.

By the seventeenth article of the lease it is further provided that the Central Road at the

“Expiration or other determination of the term \* \* \* will pay over to the said party of the first part of the proportionate part of \$2 per share of the capital stock of the said party of the first part that shall be due between the period of the last payment thereof made to the stockholders in the said party of the first part and under the provisions of this contract, and the date of the surrender, together with an amount equal to the interest accrued on the bonds of the said party of the first part from the date of the last payment of interest on each kind of bonds to the date of such surrender.”

By the first supplementary contract made between the parties on the 15th day of May, 1882, it is expressly provided,

“that the said first and second articles of said contract between the parties hereto, dated April 1, 1873, shall not be changed or amended by any action of the Board of Directors of the parties thereto, or of either of them, nor by any action of the stockholders of said parties, or either of them; and that the annual rent reserved and to be paid under the said first and second articles of the said contract of April 1, 1873, shall be paid during the whole term of the said contract, and at the time and in the manner therein provided.”

So it will be seen from these quotations that the annual rent referred to in the lease included not only the dividend to be paid to the stockholders, but the interest to be paid upon the bonds.

(3.) The provision for the payment of interest on the consolidated mortgage bonds was in no sense an indemnity, but it is a mere application of the rent to be paid to the purposes for which the Harlem road desired to apply it. It is included in the term “annual rent,” as specified in the first article of

the lease. It is expressly agreed to be paid, not only by the second article, but by the supplementary contract of May 15, 1882. The money thus paid is clearly within the definition of rent, as laid down by the text writers, which is defined:

“A certain periodical profit in money, provisions, chattels or labor issuing out of lands and tenements in retribution for the use.”

3 Kent, 460.

Blackstone defines it:

“A compensation or return in the nature of an acknowledgment for the possession of a corporeal inheritance.”

2 Comm., 41.

One might as well say that the provision to pay the stockholders was an indemnity as to say that the agreement to pay this interest is an indemnity. Nor is it true, as suggested on page 6 of the brief of defendant's counsel:

“that the consideration moving to the stockholders for the lease is their guaranteed dividend. Provided this guaranteed dividend is paid at the times agreed upon the stockholders under an ordinary railroad lease have no further interest in the management of the property, except that it shall be kept in good condition, and that all charges shall be taken care of by the lessee company.”

Whatever may be the rule under an ordinary railroad lease, that is not the construction of this lease. The stockholders under this lease had a direct pecuniary interest, not only in the payment of this interest, but in the principal of the bonds themselves. If that was paid it would undoubtedly secure to the Harlem Company a continued annual rent of \$840,000. So that the contract which by its terms might give to the stockholders of the Harlem Company \$840,000 annually in addition to the dividends

upon their stock would be clearly one in which the stockholders had considerable pecuniary interest, and certainly could not in any sense be said to be a contract of indemnity.

## POINT II.

**There is nothing in the sixth clause of the lease which deprives the Harlem Company of the right to receive the payment of this interest during the whole term of the lease.**

The object of the Sixth Article of this lease is quite clear. It was, in the first place, to provide that the Central Company should pay all the bonds of the Harlem Company mentioned in Schedule "A," except the consolidated mortgage bonds, out of the proceeds of the \$7,488,000 bonds of the consolidated mortgage which were paid over to it. An examination of that schedule will show that these bonds fell due very shortly, and by far the larger portion of them within two or three years from the date of the lease, the intention being, evidently, that there should be no bonded debt of the Harlem road outstanding except the consolidated mortgage bonds, which by their terms ran much longer than any of the other bonds mentioned in Schedule "A," but as to the consolidated mortgage bonds it is quite clear that there was never intended to be any absolute agreement on the part of the Central Railroad to pay them. It will be noticed that the first part of Article VI. contains an express and absolute agreement to pay all the bonds *except* the consolidated mortgage bonds, but as to those bonds the agreement is entirely different. It agrees to pay those bonds,

"if and in case they should not be paid by the party of the first part" (the Harlem Company).

It is quite clear that under this provision it was the right, as it was clearly the duty of the Harlem Company to pay these bonds at maturity. The Harlem Company issued the bonds, and the mortgage given to secure them was a lien upon its property prior to the lease given to the Central Company. So if no contract had been made upon the subject, there never could have been any doubt as to the duty of the Harlem Company to take care of these bonds at their maturity. The contract in no way relieved the Harlem Company from that duty. The provision of the contract was simply for the purpose of enabling the Central Company to protect itself by the payment of the bonds, in case the Harlem Company for any reason was not able to do so.

The Sixth Article provides for two contingencies: In the first place, for the payment by the Harlem Company of these bonds, and if that be done, it is especially provided that the Central Company shall pay to the party of the first part thereafter semi-annually on the dates when interest would become due and payable on the bonds, if the time thereof had been extended, an amount equal to interest on said bonds, or on such part of them as might have been paid by the party of the first part.

The other contingency had in view the payment of the bonds by the Central Company. This contingency, however, need not be considered here, because there is no pretense nor can there be any pretense that the Central Company ever paid one penny to apply on these bonds, or ever made itself responsible in any way for any portion of them. The second contingency specified in the Sixth Article could only come into being if the Central Company paid the bonds, and as that company did not pay them it is not necessary to consider the effect to be given to that payment. The only question to be considered here is whether, in the first place, the Harlem Company was bound to pay these bonds and had the right to do so, and in the

second place, what was the result if the Harlem Company did pay them. So far as those contingencies are concerned, there can be no doubt that they were expressly provided for by the Sixth Article and that they provided for a continuance of the payment of a sum equivalent to the interest by the Central Company.

There is nothing in the Sixth Article which draws any distinction or suggests one, between the extension of the bonds and the payment of the bonds. The word "payment" is used to describe the act which will give the Harlem Company the right to demand the continued rent of an amount equal to the interest, and the word "extended" is used to fix the date upon which that amount should be payable by the Central Company. If the payment was made the amount to be paid was the same as though the original bonds had been extended. The words are not used in contradistinction to each other, nor do they relate to the same subject matter. Neither word affects, or was intended to affect, or could affect, either the right of payment by the Harlem Company or the manner in which that payment should be made.

### POINT III.

**There is nothing in the lease which precludes the Harlem Company from procuring the money for this payment in the ordinary way in which railroads are accustomed to provide for the payment of their indebtedness.**

It is suggested by the defendant that the word "payment" as used in the first part of the

Sixth Article of this lease can only mean a devotion by the Harlem Company of money actually in its treasury to the satisfaction of the bonds, or some portion of them, and that there is an implied prohibition of the right to use any of its credit to obtain the money for this payment. But it is claimed in the same breath that upon the construction of the second clause of the Sixth Article the word "payment," when applied to the act of the Central Company, means the act of devoting the proceeds of the bonds of the Harlem Company to the taking up of the consolidated mortgage bonds, and that that does not require on the part of the Central Company the use of any money, but it authorizes that company to require the Harlem Company to issue new bonds, which it may use to take up the old bonds, with the result that the Central Company, without advancing one penny out of its treasury, shall have the benefit of the credit of the Harlem Company, and take away from it and put into its own treasury just one-half of the amount of rent which it agreed to pay. If the word "payment" means only the use of money in the treasury by the Harlem Company the word "payment" must mean the same thing when applied to the act of the Central Company. To warrant the construction claimed by the Central Company the same word as used in different parts of the same article must have two different meanings when applied to the same act.

There is nothing in the Sixth Article which either expressly or by fair implication limits in any way the rights of the Harlem Company to procure the money to pay these bonds as it sees fit. If it had the money in its treasury undoubtedly it could devote it for that purpose, or so much of it as it saw fit. If, on the contrary, it had no money in its treasury, there is nothing in the Sixth Article, or as it will be shown, anywhere else, to prevent the Harlem Company mortgaging either the property demised by the lease, or any other of

the property, to procure the money to pay these bonds. The right of the Harlem Company depends upon the fact of payment, without regard to how the money shall be obtained. The consolidated mortgage was a lien upon the demised property superior to the lease of the Central Railroad, and upon the foreclosure of that property undoubtedly the lease would be at an end if the property were bought by anybody except the Central Railroad itself. It may be that the Central Company was entitled when the consolidated mortgage bonds were paid to have it done in such a way that the lien of the mortgage should be discharged so far as its lease was concerned, but beyond that it clearly had no interest whatever, either in the manner of payment or in the question of what property should be mortgaged. If, after the consolidated bonds were paid its property ceased to be subject to the lien of the mortgage which secured them, all the interest which the Central Company had in the payment, or in the manner of it, was entirely gone. This was provided for by the Harlem Company by the express provision that the new issue should be made subject to the lease. If those bonds were not paid the foreclosure of the mortgage given to secure them would not interfere in the slightest degree with the rights of the Central Company, but the only change would be that the rents would be payable to the purchaser on foreclosure.

No provision of the lease provides for an increase or diminution of this rental. In the absence of any provision so providing an increase or diminution of the rent cannot be implied. Had the new bonds been issued at ten per cent. interest and the Harlem Company should claim an annual rental equivalent to ten per cent. upon the \$12,000,000 of new bonds, such claim would be negated by the express provision of Article Sixth of the lease, which provides: "In case of the payment thereof (Consolidated Mortgage Bonds) or some or any part thereof (Consolidated Mortgage

Bonds) by the said party of the first part, then, and in that event, the said party of the second part (Central Company) shall thereafter pay to the said party of the first part (Harlem Company), semi-annually, on the days when interest would become due and payable on said bonds (Consolidated Mortgage Bonds), if the time thereof had been extended, *an amount equal to such interest on said bonds*" (Consolidated Mortgage Bonds). Thus the obligation of the Central Company is to pay, not an amount equal to the interest on any new bonds, whether it be ten per cent. or any other sum, but an amount equal to the interest on the consolidated mortgage bonds, which is seven per cent., "so as *fairly* to adjust the obligation of the Central Company" herein contained as to the *annual rent*. What annual rent? Clearly that fixed by the First and Second Articles of the lease at a sum equivalent to two dollars a share on the capital stock and seven per cent. on the consolidated mortgage bonds, the latter amounting to an annual rent of \$840,000.

#### POINT IV.

**Article Fifth of the lease cannot be construed as forbidding the issue of bonds to take up the consolidated mortgage bonds.**

Article Fifth reads as follows:

"The said party of the first part covenants and agrees that it will not during the continuance of this contract, authorize, create, or issue any stock or bonds *additional to the amounts thereof respectively now authorized or outstanding* as hereinbefore stated, except at the request or upon the demand of the said party of the second part as hereinafter set

forth. Provided, however, that the said party of the second part may at the request of the said party of the first part, and for purposes connected with operating the street railroad hereinafter mentioned, abate the covenant of the said party of the first part contained in this article, but any abatement shall be entirely at the option of the said party of the second part as to granting at all or as to the extent to be granted."

The object for which this article was inserted in the lease is quite clearly to be ascertained. In the first place, it was intended that the bonded debt of the Harlem Company should never be increased, and in the second place it was intended that no new bonds should be issued by the Harlem Company for the benefit of the street railroad portion of its property without the consent of the Central Company. It is not at all clear that any provision which took away from the Harlem Company the right to issue its bonds would be valid in law, but without considering here whether or not this covenant is valid, it is sufficient to say that it cannot be so construed as to prevent the Harlem Company from issuing new bonds to take up the old bonds which were about to fall due. The wording of the covenant clearly shows that that was its intent. It was not an agreement on the part of the Harlem Company that it would not issue any new bonds or any additional to those now outstanding, or any bonds other than those outstanding, or any bonds at all, but the covenant was expressly limited to an agreement not to issue any bonds additional to the amounts now outstanding, and there is no possible construction which can give it any broader meaning than that. It is quite clear that the meaning thus given to it accomplished every purpose which the parties had or could have in view. It left the power of the Harlem Company to borrow money just where it was. If the Harlem Company saw fit to issue new bonds to take up the old bonds it

made the new issue of bonds necessarily subject to the lease and thereby relieved the interest of the Central Company from the lien and charge of the consolidated mortgage bonds, which were superior to its interest under the lease.

In the resolution to issue the new bonds it was made an essential condition to the issue of them that at no time shall there be authorized, issued, or outstanding more than \$12,000,000 principal of the bonds of the New York and Harlem Railroad Company, and the resolution also provided that the new bonds should be issued to such amount as should be necessary to pay or provide for the payment of at least an equal amount of the consolidated mortgage 7 per cent. bonds, such progressive payment of at least an equal amount of said consolidated mortgage bonds being an essential condition of the issue of its new bonds.

#### **POINT V.**

**Article Fifth of the lease is void if its effect is to prevent the Harlem Company from borrowing money by the issue of new bonds to pay the consolidated mortgage bonds, and hence the discontinuance of the Central action against the Harlem Company, to restrain the issue of bonds based upon that article, cannot, independent of all other considerations, furnish any consideration for the second supplementary contract.**

The obligation on the part of the Harlem Company to pay the consolidated mortgage bonds existed at the date of the lease. The obligation was

a continuing one. The power to borrow money for that purpose by the issue of bonds secured by mortgage was a corporate power conferred upon the Harlem Company by the general statutes of the State. It was not competent for the Harlem Company to agree with the Central Company or with any other corporation not to exercise that corporate power except at its request or with its consent. A board of directors of a corporations cannot delegate its corporate powers, which involve the exercise of judgment and discretion on their part, to others (Cook on Corporations, 3rd Ed., Vol. 2, § 715).

There are few powers conferred upon corporations of greater importance than that of borrowing money upon bonds secured by mortgage for corporate purposes.

In any action by the Central Company, based upon the provisions of the Fifth Article of the lease, to restrain the Harlem Company from borrowing money by the issue of new bonds to pay the consolidated mortgage bonds, it would be a complete answer to say:

FIRST.—The right to borrow money by the issue of new bonds secured by mortgage is a corporate right conferred by statute upon railroad corporations, and it is not competent for one corporation to surrender that power to another or to make the right to exercise it dependent upon the request or consent of such other corporation.

SECOND.—The issue of bonds in violation of the Fifth Article of the lease could not possibly damnify the Central Company.

This last is clear beyond all question.

Any mortgage securing the new bonds would of necessity be subject to the lease, even without the provision to that effect, as is the case in the mortgage securing the new issue of bonds by the Harlem Company. How could the Central Company be damnified by the issue of new bonds by the Harlem

Company? Its rent would not be increased thereby, nor its obligations to the Harlem Company, or the Harlem Company's obligations to it, in any way affected. It could suffer no damage, real or fanciful, from the issue of new bonds by the Harlem Company, even if such issue were a violation of any provision contained in Article Fifth of the lease.

It is clear, therefore, that the colorable suit instituted by the Central Company against the Harlem Company, based upon the provisions of the Fifth Article of the lease to restrain the issue of bonds, would have failed even if it had not been discontinued. Certainly, it would have failed since its allegation, that by the issue of the new bonds the bonded indebtedness of the Harlem Company would be increased, is upon this motion admitted to be false and known to the Central Company, its directors and officers to be false.

Surely the plea that the discontinuance of this baseless and colorable suit furnishes a consideration for the second supplementary contract is not entitled to any weight or consideration.

## POINT VI.

**The allegations of the complaint establish a fraudulent breach of trust on the part of the directors of the Harlem Company and a fraud upon that company and its stockholders.**

(a.) Upon this motion the case is to be treated precisely as though the defendant had demurred to the complaint, and not only is every fact stated in the complaint admitted, but every inference which might fairly be drawn from those facts by reason-

able and fair intendment is admitted precisely as though they were alleged in the complaint.

*Flynn vs. Brooklyn City Railroad*, 158 N. Y., 493-503.

*Sage vs. Culver*, 147 N. Y., 241.

*Kley vs. Healey*, 127 N. Y., 555.

*Marie vs. Garrison*, 14 N. Y., 23.

While under the authorities there is some disagreement as to whether the directors of a corporation are to be regarded as trustees, all authorities agree that they sustain to the corporation and its stockholders a fiduciary relation, which charges them with the responsibilities and obligations of trustees when their acts are under review in a Court of equity.

*Bosworth vs. Allen*, 168 N. Y., 157.

The duty of a director of a corporation to the corporation and its stockholders is to manage its affairs with care and prudence and absolute good faith, and to assert its rights and protect its interests with firmness and diligence.

The allegations of the complaint establish that the directors of the Central Company, a majority of whom constituted a majority of the directors of the Harlem Company and who dominated and controlled the policy of the Harlem Company, their financial interests in the Central Company being much greater than in the Harlem Company, combined with the Harlem Company, through its Board of Directors, to release the Central Company from an obligation to pay an annual rent of \$220,000 for a period of 373 years and 11 months, amounting in the aggregate to upwards of \$82,200,000. The complaint charges, and this motion admits, that the second supplementary contract, which works this great loss, damage and injury to the Harlem Company and its stockholders, was not founded upon any good, valuable, equitable or other consideration, and was against the interest of the Harlem Company and its stockholders, and

was intended to be in the interest of the Central Company (Complaint, pp. 21-22, fols. 63-65).

It is further admitted upon this motion that an action was commenced by the Central Company against the Harlem Company to enjoin it from issuing the new bonds upon the ground that they would increase the bonded indebtedness of the Harlem Company, which allegation it is admitted was false and was known to the Central Company, its officers and Board of Directors to be false (Complaint, pp. 13-14, fols. 37-41).

It is further admitted that this action was not instituted in good faith or for the purpose or with intent of prosecuting the same to judgment, but was only commenced for the purpose of discontinuing the same and thereby furnishing a colorable excuse or pretended consideration for the second supplementary contract, depriving the Harlem Company of rent, amounting in the aggregate to upwards of \$82,200,000 (Complaint, p. 15, fol. 45).

It appears, too, from the complaint, that the Central Company never believed that it had any right or claim to a reduction in its rent, as in announcing the second supplementary contract to its stockholders, it says:

“Under its provision a *saving* of over \$200,000 per annum in fixed charges will be effected by the New York Central and Hudson River Railroad Company.”

The use of the word “*saving*” in this circular is an admission by the Central Company that its suit was baseless, and that but for the second supplementary contract it would have had to pay an additional annual rent of \$220,000 per year, amounting in the aggregate to upwards of \$82,200,000.

These various admissions of fact establish beyond all question a most flagrant and fraudulent breach of trust upon the part of the Harlem directors.

(b.) The bond transactions set forth in the complaint also establish a clear breach of trust and

actual fraud on the part of the directors of the Harlem Company.

Stripped of legal verbiage those transactions may be correctly described as follows:

The Harlem and Central companies are each about to make an issue of one hundred year gold bonds bearing interest at the rate of three and one-half per cent. per annum.

The Central Company is to issue bonds of the face value of \$85,000,000.

The Harlem Company is to issue bonds of the face value of \$12,000,000.

J. P. Morgan, of the firm of J. P. Morgan & Co., of New York, and of J. S. Morgan & Co., of London, is a director of the Central Company and a stockholder in the Harlem Company.

These firms, associating with themselves *favoured* directors and stockholders of the Central and Harlem Companies, as a syndicate, secure the entire issue of \$85,000,000 of Central bonds, and \$12,000,000 of Harlem bonds at prices greatly below their market value. As purchasers of the Central bonds they exact for themselves and their associates from the seller a commission of \$2,975,000, admitted to be millions of dollars in excess of a just, fair and reasonable commission (Complaint, p. 20, fol. 59). The price paid for the bonds too, is admitted to be millions of dollars less than their fair market value.

As purchasers of the Harlem bonds, they exact from the Harlem Company a commission of \$420,000, which is admitted to be hundreds of thousands of dollars in excess of the commission for which responsible bankers would have undertaken the sale of the bonds; and it is further admitted that the price at which the bonds were sold were very much below their market value (Complaint, p. 19, fol. 57).

The Harlem bonds were sold by the syndicate to another syndicate at a profit of \$960,000 (Complaint, p. 19, fol. 57).

The Central bonds were sold at a profit of \$7,650,000 (Complaint, p. 21, fol. 61).

It thus appears that under the terms of sales of the bonds commissions were allowed as follows:

Harlem bonds.....	\$420,000
Central bonds.....	2,975,000
<hr/>	
Total commission.....	\$3,395,000

It also appears that the profit realized by the syndicate on the sale of the bonds was, including the commission, as follows:

Harlem bonds.....	\$960,000
Central bonds.....	7,650,000
<hr/>	
Total profits.....	\$8,610,000

At the date of the sale of the Harlem bonds at a price admitted to be very much below their market value, and at the date of the sale of the Central bonds at a price admitted to be millions of dollars less than their market value, the statutes of the State provided that bonds should not be sold for less than their market value.

It is apparent from the allegations of the complaint that the Harlem bonds were a gilt-edge security. The capital of the Harlem Company was only \$10,000,000, and its bonded indebtedness was only \$12,000,000, and on June 1st, 1897, the date of the new mortgage, it is admitted the value of the corporate property of the Harlem Company, as indicated by the selling price of its stock, was upwards of \$40,000,000 (Complaint, p. 11, fol. 32). Indeed, the fact that the Harlem bonds were sold by the second syndicate at a premium of fifteen per cent., realizing an advance over the price for which the Harlem Company sold them, of \$1,800,000, is proof positive of the high and valuable character of the security, and explains why they were used to *sweeten* the issue of the Central Company's bonds.

It is little surprising, in view of the bond transactions above detailed, that the counsel for the defendants has made his plea that the second supplementary contract is not stained with the fraud which he admits they indicate.

Always bearing in mind that both the Harlem and Central Company directors are conceded to have been interested in the purchase of the Central Company bonds, and that the Court has the right to draw all just and proper inferences from the facts admitted or susceptible of proof under the allegations of the complaint in determining the question of its sufficiency, we proceed to designate the facts and circumstances which make the purchase of the Central Company's bonds the inspiration of the second supplementary contract.

The sale of the Central bonds was completed on the 8th day of April, 1897 (Complaint, p. 20, fol. 59).

The sale of the Harlem bonds on the 8th of June, 1897 (Complaint, p. 19, fol. 56).

On May 27, 1897, the Harlem Company authorized the execution of the new mortgage, and on or about June 1, 1897, the new mortgage was executed and delivered to the Guaranty Trust Company, the trustee named therein.

As soon as the new mortgage was executed the Central Company commences its colorable suit against the Harlem Company to enjoin the issue of bonds (Complaint, p. 13, fol. 37).

The complaint in the action is conceded to have contained false allegations, known to be false (Complaint, p. 13, fols. 38-40), and the action is also conceded to have been instituted only for the purpose of discontinuing the same and thereby furnishing a colorable excuse and pretended consideration for the Second Supplementary Contract (Complaint, p. 15, fol. 45).

On the 28th of September, 1898, the Hitchcock action is commenced, restraining the execution of the Second Supplementary Contract, which is discontinued for a consideration by the procurement

and with the privity of the Harlem Company (Complaint, p. 16, fol. 47; p. 17, fol. 49).

In the meantime, on August 10, 1898, the Joint Committees of the Harlem and Central Companies meet. Mr. Morgan, a director of the Central Company and member of the Syndicate for the purchase of the Central and Harlem bonds, is a member of this committee, and on his motion the Second Supplementary Contract, which releases the Central Company from its obligation to pay to the Harlem Company rent amounting to upwards of \$82,200,000, is approved and resolutions adopted recommending its execution. It is a significant and admitted fact that this amount of \$82,200,000, thus diverted from the Harlem Company and *saved* to the Central Company without interest added, nearly equals the \$85,000,000 principal of the Central bonds purchased by the Syndicate, and with interest added will, at the date of the maturity of the Central bonds, exceed the principal of the entire issue by unnumbered millions.

The entire scheme, as is apparent from the allegations of the complaint, was engineered and directed by the directors of the Central and Harlem Companies interested in the syndicate for the purchase of the Central Company's bonds. They well knew, as any one can see, that this great reduction of upwards of \$82,200,000 in the fixed charges of the Central Company would add value to the Central Company's bonds and result in increased profits to the syndicate.

The legitimate inference from the facts admits of but one conclusion, and that is that one of the chief and inspiring causes which induced the dominating and controlling directors of the Central Company and of the Harlem Company to effect the great reduction of upwards of \$82,200,000 in the Central's fixed charges was to increase the market value of the Central bonds, and so increase the profits of the syndicate, composed in part of Central and Harlem directors and shareholders.

There can be no doubt that the bond transactions involved a fraudulent breach of trust.

Neither argument nor authority is required to establish the fraud and breach of trust involved in these bond transactions.

The sale of the bonds below their market value was expressly prohibited by statute, and the great difference between the price at which the bonds were sold to the syndicate and their actual value, is itself a conclusive badge of fraud. When to this is added the fact that the directors and stockholders of the Harlem Company and the Central Company are admitted to have been interested in the purchase of the bonds and in the enormous commissions allowed, commissions admitted to be, in the case of the Harlem bonds, hundreds of thousands of dollars in excess, and in the case of the Central bonds, millions of dollars in excess of a reasonable and fair commission, there can be no doubt of the fraudulent character of the transaction.

It was the plain duty of the directors of the Harlem Company, if stockholders were to share in the profits derived from the sale of the bonds, that those profits should not be distributed among *favored* directors and stockholders, but that all and every of the stockholders should have an equal chance to share in those profits.

The stock owned by the plaintiffs made them equitable owners of an undivided fractional part of the entire assets of the Harlem Company (*Flynn v. Brooklyn City R. R. Co.*, 158 N. Y., p. 504). As such equitable owners they were entitled to share equally with the favored stockholders, members of the syndicate, in all profits to be derived from the sale of the Harlem bonds. It was the duty of the directors of the Harlem Company to see that no preference was given to any stockholder. They violated that duty in selecting favored stockholders, in diverting the profits on the sale of the bonds from the great body of the stockholders to themselves and their favorites.

The complaint charges and this motion admits that had the bonds of the Harlem Company been offered to the Harlem stockholders at the same price at which they were sold to the syndicate, every penny of profit that was realized by the purchasers and syndicate by way of premium would have been realized by the Harlem stockholders (Complaint, pp. 19-20, fols. 57-58).

The allegations of the complaint, admitted upon this motion with respect to the bond transactions, establish a combination between directors of the Central Company and directors of the Harlem Company to secure to favored directors and stockholders of each of the companies by an illegal sale of the bonds, involving a breach of trust, enormous commissions and profits, to the great damage and injury of the Harlem Company and its stockholders, amounting to millions of dollars in commissions and millions of dollars in profits.

These bond transactions were contemporaneous with the proceedings resulting in the second supplementary contract, were in part the inspiration of that contract, and, so far as they relate to the Harlem bonds, are wedded to that contract beyond all possibility of divorce by the clause in the second supplementary contract which provides that nothing therein contained shall affect *the contract for the sale of the Harlem bonds*.

The bad faith of the transaction is conclusively shown by the fact that while the directors of the Harlem had, as events showed, the power to raise the necessary means to pay off the bonds under the first provision of the sixth clause, thereby confessedly making a saving to the Harlem of over \$420,000 a year, as to which no dispute could possibly arise, they deliberately selected the other method, for the purpose of raising a pretended controversy and benefiting themselves as stockholders. This fraud should set aside the entire transaction.

It is not an answer to this to say that the defend-

ant stockholders have a remedy against the directors individually. They should not be compelled to resort to that remedy, so long as any other relief can be granted. The probable inability of some of the directors to respond to the heavy damages incident to such an action would of itself be a conclusive argument against depriving stockholders of their right to undo the wrong practiced upon them.

## POINT VII.

### **The discontinuance of the action commenced by the Central Company against the Harlem Company is no defense to this action.**

(a.) The claim is that the discontinuance of that action operated as a settlement and a compromise of a dispute between the Harlem and Central Companies as to the construction of the lease and as to their respective rights thereunder. A dispute to operate as a sufficient consideration for a contract must be of a claim that is really disputed and doubtful. If the claim is unfounded and palpably untenable and there is fraud and the parties do not meet on equal terms, they will not be precluded from opening it.

Farmers' Bk. *v.* Blair, 44 Barb., 641, 652, 653.

Wahl *v.* Barnum, 116 N. Y., 87, 95.

Scott *v.* Warner, 2 Lans., 49, 52.

Taplin *v.* Wilson, 6 T. and C., 502, 504.

It is admitted that the action in question was not commenced in good faith, or with any intention of prosecuting it to judgment, but solely for the purpose of furnishing a colorable consideration for the

second supplementary contract (Complaint, p. 15, fol. 45).

It is also admitted that the second supplementary contract was not founded upon any valuable, equitable or other consideration (Complaint, p. 21, fol. 63). In view of these admissions and the fraudulent character of the transactions resulting in the alleged settlement of the dispute, there is no basis for the contention that a compromise of the fictitious dispute between the two corporations constitutes any defense to this action.

(b.) Even had there been an honest dispute between the two corporations as to the construction of the lease, it could not have been settled by the directors, constituted as they were, so as to finally conclude either of the corporations or a disputing stockholder. It must be remembered that a majority of the Board of Directors of the Harlem Company at all times constituted a majority of the Board of Directors of the Central Company. Such being the constitution of the Board of Directors of each company, any contract made by them in settlement of the dispute of even an honest difference of opinion as to the construction of the lease would be at all times open to review by a court of equity at the instance of either of the corporations, or an objecting stockholder. Especially is this true in a case where, as in the case at bar, it is admitted that the contract claimed to have effected the alleged compromise, was authorized by votes of directors of the Central Company who were at the same time directors of the Harlem Company and interested in the bond transaction set forth in the complaint, which bond transaction the contract of settlement ratified and approved.

There is high and controlling authority to the effect that such a contract is absolutely void at the election of the corporation or any stockholder.

Munson v. S. G. & C. R. Co., 103 N. Y., 58, 73, 74.

- Met. Ele. R. Co. v. Man. Ele. R. Co.*, 11  
Daly, 377, 485.  
*Trim Lick Oil Co. v. Marbury*, 91 N.  
D., 587.  
*Pearson v. Concord R. Co.*, 62 N. H.,  
537.

It is certain that the action of a board of directors, composed as were the boards in question, was voidable by either corporation or any of their stockholders.

- Met. El. R. R. Co. v. Man. Ele. R. R. Co.*, 11 Daly, 377, 483, 486, 497, 503, 522.  
Cook on Corporations, Sec. 658.  
Morawitz on Corporations, Sec. 528, 529, 530.  
*N. Y. Cent. Ins. Co. v. Nat. Pro. Ins. Co.*, 14 N. Y., 85.  
3 Thompson on Corporations, Secs. 4081-4082.  
*Met. Ele. Co. v. Dom. Telegraph Co.*, 44 N. J. Eq., 568, 573.  
*S. D., &c., Co. v. Poc. Beach Co.*, 33 L. R. A., 788.

In such case the rule most favorable to defendants is that the Court will examine the transactions and if it be one which is within the power of the directors and free from fraud, will decide whether it is fair and just and, if it is not, will set it aside.

Cook on Corporations, Sec. 658 and  
Note on page 1310.

(c.) The common directors constituting a majority of each corporation could no more fix as against the Harlem Company the fact of a dispute than they could bind the Harlem Company by the terms of the compromise of the dispute. It took two parties to do one as well as the other, and, therefore, when the Court comes to examine the propriety and legality of the action of the two bodies of directors,

it will, necessarily pass upon the ultimate rights of the parties as well as the question of the validity of the settlement in respect of those rights. It must not be forgotten that the dispute, so far as appears from the complaint in this action, was originated only by the untruthful complaint in the action of the Central Company against the Harlem Company, which is admitted to have been brought for the sole purpose of furnishing color of consideration to the settlement. There never was any other dispute. Not only was there no *bona fide* suit, but there never was a judgment. Indeed, it is admitted that there never was intention of prosecuting the suit (Complaint, p. 15, fol. 45). When directors of a corporation raise a dispute between their respective companies, and they, constituting a majority of the directors in each company, undertake to bring an action to have the Court settle the dispute and then settle it themselves, it cannot be that their *cestui que trusts* are bound by their action in a matter which, from the beginning to the end, is and is intended to be only colorable.

It was not possible under the circumstances that this suit, whatever may have been its result, could estop the minority stockholders from asserting the rights of the corporation.

Upon the undisputed facts, these common directors were in control of both corporations. What action should be brought or defended, or whether any action should be brought or defended, was purely within their discretion or control. If an action was brought, it was for them to say whether it should be defended and what defense should be interposed, so there was no possible way in which an independent litigation, brought by one company, could be independently defended by the other. In such cases as that, no judgment could have been entered which would be conclusive upon minority stockholders or any other persons who were adversely interested, even conceding that the action

had been brought in good faith for the purpose of obtaining a settlement of the dispute.

Spring Gold Co. *v.* Amador Gold Co.,  
145 U. S., 300.

Woodpaper Co. *v.* Heft, 8 Wall., 333.

The situation presented here is precisely the situation presented by Judge Nelson in his opinion in the case last cited. "The plaintiff and defendant have the same interest, and that interest adverse, and in conflict with the interest of third persons, whose rights would be seriously affected, if the question of law was decided in the manner that both parties to this suit desire it to be."

That being the situation presented in the case just cited, the Court dismissed the case and refused to make any judgment in respect of it.

In the case of the Spring Gold Company *v.* Amador Gold Co. (*supra*), it appeared that a minority of the stockholders of the defendant in error had an interest in the suit which might possibly be adverse to the claims of either of the parties to the action. It also appeared that after the action had been determined at the Circuit Court both corporations had come under the control of the same persons. That being made to appear to the Court, the judgment was reversed so that the minority stockholders might not be precluded by it from bringing an action to assert their rights in defiance of those claimed by the corporation. So that, if there had been a judgment in this case, it clearly would not, within these authorities, have been conclusive as against the rights of the minority stockholders.

But the settlement by agreement was clearly absolutely without any effect upon those rights, and no reason can be suggested why the corporation is not at liberty to question the act of their common directors, as was done in the case of the Metropolitan Elevated R. R. Co. against the Manhattan Elevated R. R. Co. (11 Daly, 374), and if those acts may

be questioned by the corporation, they clearly may be questioned by a minority stockholder suing in behalf of the corporation, under the circumstances presented here, as will be shown hereafter.

The common directors might have resigned from one board and after their places had been filled the newly constituted board might have prosecuted an action, brought in good faith, to judgment, and thus in the absence of fraud have bound the corporation.

But this procedure did not accord either with the interests or the plans of the interested common directors of the two companies.

### POINT VIII.

**The claim that the contract in question is susceptible of ratification by the body of the stockholders, and, hence, a single stockholder cannot bring this action, is not well taken.**

(a.) In the first place, there is nothing to show that the claim has ever been ratified by the stockholders. The allegation of the complaint, which is admitted, is that "a majority of the Board of Directors also constituted a majority of the Board of Directors of the Harlem Company, and such majority owned and controlled a majority of the stock of both companies and dominated the policy and controlled the management of each company." This admitted allegation brings the case clearly within that of the *Farmers' Loan & Trust Co. v. N. Y. & N. R. R. Co.* (150 N. Y., 410), and the *dictum* of Judge Peckham in *Gamble v. Queen's County Water Co.* (123 N. Y., 91), which was followed in the *Farmers' Loan and Trust Company* case above cited. But the fallacy of the argument clearly ap-

pears when it is considered that if this contract is voidable it does not necessarily require the assent of a majority of the stockholders to bring about a ratification. Such a ratification may be brought about by acquiescence as well as by express assent.

*Kent v. Quick Silver Mining Co.*, 78 N. Y., 159.

3 Thompson on Corporations, Sec. 4085.

4 Thompson on Corporations, Sec. 4494.

The acquiescence which will ratify such a contract may be shown simply by a failure to find fault with it. Therefore, if a stockholder cannot sue to set aside the contract, after a proper demand upon a corporation to do so, we have this condition of affairs: That no action need be taken by a majority of the stockholders to ratify the contract; it is ratified by the delay and any minority stockholder who is opposed to the contract cannot bring the action because the majority of the stockholders may ratify it; and so, while he is waiting for the majority of the stockholders to take action which they do not see fit to take, he becomes estopped from bringing suit because the contract has been ratified by the inaction of the corporation. A more complete way of tying the stockholders "hand and foot" could not well be imagined.

The cases cited by the counsel for the defendant on this question are easily distinguishable. The proposition of the plaintiff here is that, upon the admitted statement of the case in the complaint, this contract is oppressive and unfair to the Harlem Company and a waste of its funds. Those facts being conceded, the case is taken out of several of those which are cited in the brief of the defendant's counsel.

The case of the *Salem Iron Co. v. Lake Sup. Cons. Mining Co.* (112 Fed. Rep., 239), was decided upon the proposition that the contract complained of made by the president, who acted in his dual capacity of president and also as partner of a firm of

which he was a member, was made in the usual usual course of the company's business, in the usual way and at the usual price; and that the president obtained no advantage in making the contract. For that reason it was held that it would not be set aside, but the Court took upon itself the examination of the contract to ascertain whether it was unfair, oppressive or fraudulent towards the corporation, and the Court discussed fully the question of the propriety of the contract.

In the cases of *Windmiller v. Standard Distilling Co.* (115 Fed. Rep., 748; 115 Fed. Rep., 748), the question was simply whether a stockholder who was not a director could be restrained from voting in his own interest on a matter presented at the stockholders' meeting, and the Court, under the circumstances, held that there was no objection to his doing so. No other question was presented in either of the *Windmiller* cases.

In the case of *Burden v. Burden* (159 N. Y., 287), affirming the same case, 8th App. Div., 160, it was held expressly that the contract was just and fair and within the authority vested in the directors by the promoters' agreement and, for that reason, the plaintiff was not permitted to maintain his action. It is to be noticed in that case, however, that the action was brought, not by a stockholder in behalf of a corporation, but by one of the stockholders in his own behalf, and that, even when it was so brought, the Court restrained the corporation from doing certain acts which were complained of and which were held to be outside of the purpose for which the corporation was organized (see the report in the Appellate Division).

(b.) In the second place the fraudulent transaction set forth in the complaint could not be condoned or ratified against the objection of a single stockholder.

## POINT IX.

**The authority of a stockholder to bring an action in his own behalf and in behalf of all other stockholders who may come in to enforce the right of a corporation for its benefit against transactions of the character of those set forth in the complaint, cannot successfully be disputed.**

This right is thoroughly established by the following authorities:

- Flynn *v.* Bklyn. City R. R. Co., 158 N. Y., 493.
- Barr *v.* N. Y., L. E. & W. R. R. Co., 125 N. Y., 265, 272.
- Currier *v.* N. Y., W. S. & B. R. Co., 35 Hun, 355.
- Stokes *v.* Phelps Mission, 47 Hun, 570.
- Rogers *v.* N. C. & St. L. R. Co., 91 Fed. Rep., 299.
- Sage *v.* Culver, 147 N. Y., 241.
- Pearson *v.* Concord R. R. Corporation, 62 N. H., 537.
- 4 Thompson on Corporations, Secs. 4480 *et seq.*

## POINT X.

**The motion to dismiss the complaint should be denied.**

WILLIAM RUMSEY,  
WILLIAM C. TRULL,  
Of Counsel for Plaintiffs.

[H9883]

























# Supreme Court,

COUNTY OF NEW YORK.

CONTINENTAL INSURANCE COMPANY,  
Plaintiff,

AGAINST

NEW YORK AND HARLEM RAILROAD  
COMPANY and NEW YORK CENTRAL  
AND HUDSON RIVER RAILROAD  
COMPANY,  
Defendants.

## **Supplemental Replying Brief on Motion to Dismiss Complaint.**

The following additional suggestions are submitted to the Referee, in view of the positions taken by counsel for plaintiff on the oral argument upon the motion to dismiss the complaint at the opening of the trial before the Referee.

### **I.**

The construction placed upon the lease by counsel for plaintiff makes the second half of Article Sixth of the lease meaningless and purposeless.

According to counsel's contention, the Harlem Company had the absolute right to issue new bonds and

to make a new mortgage for the purpose of raising the money to take up and cancel the consolidated bonds at maturity, and it was the duty of the Directors to issue such bonds and to make such mortgage for that purpose, thus securing to the Harlem stockholders the benefit of the saving in interest thereby accruing. If this be the true construction of the lease, then there would be no contingency in which the obligation of the lessee company to take up the consolidated bonds, would take effect; and, therefore, there would be no contingency in which the lessee company would have the right to call upon the lessor company to issue its new bonds and make its new mortgage and to deliver the new bonds to the lessee company. It would follow from this that the elaborate provision made by the Sixth Article of the lease for the contingency of non-payment by the lessor company of the consolidated bonds, was a waste of ink and paper. As much as this was virtually conceded on the oral argument by the counsel for the plaintiff, for he was unable then to suggest any contingency in which, if the Harlem Directors did their duty, this provision of Article Sixth would become effective.

## II.

Counsel for plaintiff plants himself upon the proposition that the same word, "paid," is used in both clauses of Article Sixth—both the clause relating to the lessor and the clause relating to the lessee.

Counsel argues that if this word is to be construed, so far as the lessor is concerned, as requiring actual payment out of the general assets or funds of the lessor company, and to exclude "extension" of the debt or substitution of securities, the same construction of the phrase must be made when applied to the lessee company. Counsel argues from this proposition that if the lessee company pays the consolidated bonds

out of the proceeds of the new bonds, or by substitution of the new bonds for the old, then the consolidated bonds have not been "paid" by the lessee company within the meaning of the lease.

This reasoning, however, overlooks and leaves out of account the covenant obligation of the lessee company with regard to payment of the bonds. The sixth article of the lease starts out by an express covenant on the part of the lessee by which the lessee assumes the absolute duty of payment:

"The said party of the second part covenants and agrees that it will pay the principal of all the bonds described in said Schedule 'A' other than the bonds therein described as 'Consolidated Mortgage due May 1, 1900,' as they shall respectively mature and be presented for payment; and that it will, at the maturity thereof, pay the principal of the said 'Consolidated Mortgage' bonds if and in case it should not be paid by the said party of the first part."

This covenant imposed upon the lessee the absolute and unqualified duty of paying the entire principal amount of the consolidated mortgage at maturity. This obligation became a charge upon the general assets of the lessee company, and it would be the duty of the lessee company to make such payment out of its own funds, or by mortgaging its own property, or by raising the money upon its own credit. For the non-performance of this obligation, there could be but one excuse—namely, the payment of the consolidated mortgage bonds by the party of the first part—that is, the lessor company—out of its assets or general funds.

In May 1897, when the controversy first arose, there was no pretense that at maturity the Harlem company would pay, or would be able to pay, the consolidated mortgage bonds. The only scheme then proposed by the Harlem company was a refunding scheme, which involved the issuing of new bonds and the making of a new mortgage, and the substitution of the new bonds

for the old, which would be equivalent to an extension of the indebtedness secured by the consolidated mortgage.

If we are correct in our construction of the next clause of this article, such substitution or extension would not be a payment of the mortgage bonds by the lessor company. It follows, therefore, that in May, 1897, and from that time on until May 1, 1900, the lessee company remained charged with the obligation and duty "to pay" the principal of the Consolidated Mortgage bonds at maturity. This obligation to pay was absolute. Had it proved impracticable to float the new bonds of the Harlem Company, the lessee company would have been obliged to draw checks upon its own treasury, for the payment of the consolidated bonds when presented at maturity. This was the situation when the controversy arose, and this was the situation when the compromise agreement was adopted. It was in anticipation of such a condition, and in view of the absolute obligation to pay the bonds at maturity cast upon the lessee by the terms of the lease, that the third clause of this article came into effect, viz.:

"In case, however, the said 'Consolidated Mortgage' bonds shall be paid by the said party 'of the second part' (that is to say, in case the bonds shall not be paid by the lessor company out of its own assets, but shall become payable under the terms of this lease, by the lessee company, out of its assets) "the said party of the first part agrees that it will, whenever requested by the said party of the second part so to do, issue, in lieu thereof, new bonds bearing a similar rate of interest, or such other rate as may be agreed upon, with, so far as it may be required, proper coupons or interest warrants therefor appended, and secured by a suitable mortgage upon the railroad property and franchises hereby demised; such bonds to be payable at such time or times, and to such person or persons, as may be prescribed by the said party of the second part; and will issue such new bonds to the said party

“ of the second part, *to be sold or disposed of at its discretion* ; in which case the obligation of the said party of the second part herein contained, with regard to the payment of interest on the said ‘ Consolidated Mortgage ’ bonds, shall be deemed and held to apply to interest on such new bonds.”

The scheme here provided for was that the new bonds of the Harlem Company should be delivered to the lessee company for sale or disposition at its discretion, to raise a fund to indemnify the lessee company for its obligation to pay the old bonds. The obligation, however, is absolute and unqualified, and if the new bonds had proved not to be salable at par, the lessee company would have been saddled with a deficiency.

The construction which we place upon the lease gives force and effect to every provision, and we submit is rational and intelligible. The construction put upon the lease by counsel for the plaintiff makes the third clause of Article Sixth superfluous and meaningless, and is, we submit, most unreasonable.

To sum up our position, it is this : Article Sixth of the lease provides for two contingencies, and only two—

FIRST. Payment by the lessor company out of its own assets, of the whole or a portion of the Consolidated Mortgage, and the cancellation, in whole or in part, of the mortgage debt and the mortgage lien—in which event the lessor company would become entitled to be subrogated to the rights of the bondholders whose mortgage had been cancelled, to the extent that the mortgage lien had been cancelled, and thereafter during the remainder of the lease would be entitled to 7% interest, by way of indemnity for the amount diverted from its general assets for payment and cancellation of the mortgage debt.

SECOND. The non-payment of the consolidated mortgage bonds by the lessor company out of its own as-

sets and the non-cancellation of the mortgage lien, in whole or in part, in which event the lessee company would become absolutely bound to pay the consolidated mortgage bonds out of its own assets, but would be entitled to call upon the lessor company for new bonds and a new mortgage, such bonds to be delivered to the lessee company "to be sold or disposed of in its discretion"; such bonds, or the proceeds thereof to be by way of indemnity to the lessee company for its obligation to pay and discharge the consolidated mortgage bonds.

We claim that the first contingency did not take place, and that the second contingency did take place.

### III.

We again remind the Referee, however, that we are not required to satisfy the Referee that our construction of the lease is the correct one. All that we are bound to do is to satisfy the Referee that there was a fair question on which honest and intelligent minds might differ. If so, there was a question for settlement by adjustment and compromise.

We further remind the Referee that in this case the question of the *bona fides* of the suit brought by the Central Railroad against the Harlem Railroad is not controlling or even important. The question is as to the prior existence of a fair ground of controversy concerning the meaning of the terms of the lease.

### IV.

Counsel for plaintiff base their charge of actual fraud, so far as concerns the contract for the sale of the Harlem bonds, upon the proposition that the compromise agreement was intended to "fortify" the title

of J. P. Morgan & Co. and J. S. Morgan & Co. to the bonds. The argument of counsel is that certain of the directors and certain favored stockholders of the Harlem Company had an interest in the profits to be derived from the sale of the Harlem bonds, and that thus they were interested in promoting the consummation of the contract made with the Morgan firms for the sale to those firms of the bonds at par. Therefore, it was to their interest that the controversy between the two companies should be adjusted by compromise, and that the bonds should be put upon the market for sale. Counsel therefore claim that the suit brought by the Central Company against the Harlem Company was brought with the intent of laying a basis for a compromise, and that subsequently this compromise agreement was made and the suit discontinued; and that all this was done in order to remove all question as to the title to the bonds, and to enable them to be disposed of at a profit.

Counsel calls attention to the fact that in May 1897, the Central directors unanimously adopted resolutions disputing the claim of the Harlem Company, and authorizing the suit against the Harlem Company on behalf of the Central Company, although, as he claims, upon the same day the same directors of the Central Railroad, or some of them, in their capacity as directors of the Harlem Company, had voted for resolutions asserting the rights of the Harlem Company as against the Central Company.

The argument of counsel, however, overreaches itself. It seems to us very plain that the conduct of the Central directors, so far from being actuated by any personal interest in the sale of the Harlem bonds, or being with a view to quieting the title to those bonds, was quite contrary to a pecuniary interest such as is imputed by the complaint, and was calculated to throw doubt upon the title of the bonds rather than to allay doubt. In other words, in controverting the claim of the Harlem Company, and in bringing suit against the Harlem Company, the Central directors started a litigation which might last for years. The possibility of compromise or settlement of the litigation thus started

obviously was an uncertain possibility. If a majority of the Harlem stockholders should oppose a settlement, of course, none could be made. As to this, the Central directors took their chances, if, as is claimed by counsel for the plaintiff, at the time of commencing the suit in May 1897, the Central directors had in mind the possibility of settling or compromising either the suit or the controversy. The only reasonable explanation of their conduct in May 1897, is that as Central Directors they then acted from a sense of duty to the Central Stockholders, and thus raised a question which was directly contrary to their own personal interests. This could have been only because of their recognitions of their own inability to determine as to the soundness of the position which with equal propriety they or some of them had taken for the Harlem Company.

There was no reason why if they already had a contract for the sale of the bonds sufficient to give them the advantages alleged to be the motive for making it, the directors of the Harlem Company, should, if they "dominated" the policy of the Central Company, as alleged, raise a controversy which jeopardized their contract until it was finally settled, unless it be the reason that they did not *dare* to take the risk that the controversy would not be raised by others on behalf of the Central Company; in other words, unless they were afraid that they did not dominate the Central Board sufficiently to prevent the raising of this claim on the Central's behalf. This is just what we claim—that the Harlem directors who were alleged to dominate the Central Board recognized that there was a real question and that the Central Company had rights, and could fairly claim a construction of the contract which would entitle it with prospect of success to contest the right of the Harlem Company to dispose of the bonds under that contract.

So far, therefore, from showing bad faith on the part of the directors of the two companies, the resolutions adopted by the Central Company, and the suit begun by the Central Company, are the highest possible evidence of good faith.

## V.

On the question of the alleged bad faith of the directors of the Harlem Company in making the contract with the Morgan firms in May, 1897, for the sale of the new bonds *at par* we call attention to the fact shown by the complaint that a sale *at par* was unanimously ratified by the stockholders of the Harlem Company at their meeting held in May, 1897.

In view of the insistence of counsel for plaintiff that the consideration of this motion and its decision are to be limited to the explicit statements of the complaint, and his contention that the sale of the Harlem bonds and the second supplementary contract constituted one entire transaction, whereby it was intended to avoid any possible dispute which would interfere with the right of the bankers "to make a good thing out of the sale of these bonds," it is proper to call attention to the following express statements of the complaint.

Article IX. of the complaint recites the proceedings of the Harlem directors at their meeting held April 14, 1897, at which, it is asserted that, in accordance with the advice of counsel and

"in the exercise of such right and in the performance of such duty, the then Directors of the Harlem Company at a meeting of such Directors held on or about April 14, 1897, unanimously adopted certain preambles and resolutions, wherein the lease was referred to as 'said contract of lease,' and which preambles provided as follows."

As will appear upon reference to page 7 (fols. 20, 21) the second preamble began as follows :

"WHEREAS, the New York & Harlem Railroad Company can now arrange to issue and *to sell*, at a price equal to *par*, its new First Mortgage

“ Bonds bearing interest at the rate of three and  
 “ one-half of one per cent. per annum, to an  
 “ amount sufficient to pay, satisfy and discharge  
 “ all of said 7% Consolidated Mortgage Bonds at  
 “ or before the maturity thereof.”

Article X. of the complaint (p. 9, fols. 25, 26) is as follows :

“ In accordance with the last-mentioned reso-  
 “ lution, a meeting of the Stockholders of the  
 “ Harlem Company was called and held on or  
 “ about May 18, 1897, *at which the preambles and*  
 “ *resolutions adopted at said meeting of directors*  
 “ *of the Harlem Company were unanimously ap-*  
 “ *proved*, and consent and authority were given  
 “ to the execution, issue *and delivery* of such  
 “ bonds and mortgage for the aggregate principal  
 “ amount of \$12,000,000, *as in such preambles and*  
 “ *resolutions as aforesaid provided.*”

At page 11 (fols. 32, 33) of the complaint, it is alleged :

“ At or about the time of the execution of said  
 “ new First Mortgage, the Harlem Company re-  
 “ ceived and accepted a bid of responsible Bankers  
 “ in the City of New York to take all of said  
 “ bonds when issued at *a price equal* to par. By  
 “ issuing such new bonds and mortgage, with  
 “ interest at the rate of three and a half per cent.  
 “ per annum, and therewith paying off the First  
 “ Consolidated Mortgage bonds bearing interest  
 “ at the rate of seven per cent. per annum, and by  
 “ enforcing the annual payment by the Central  
 “ Company as part of its rental, after May 1,  
 “ 1900, of a sum equal to seven per cent. annually  
 “ on \$12,000,000, the Harlem Company would  
 “ increase its annual income after May 1, 1900, by  
 “ the sum of \$420,000, thereby enabling it to  
 “ increase its annual dividends to stockholders

“ after May 1, 1900, by the amount of four and  
 “ two-tenths per cent.”

These allegations of the complaint, therefore, state as facts unqualifiedly :

(1) That the directors adopted resolutions to sell these bonds at a price *equal to par*.

(2) That this resolution was unanimously approved by the Harlem stockholders at their meeting held on or about May 18, 1897.

(3) That the “ Harlem Company received and accepted a bid of responsible bankers in the City of “ New York ” (being J. P. Morgan & Co.) “ to take “ all of said bonds when issued at a price *equal to “ par*.”

(4) That the contention of the plaintiff is to obtain the benefit of the saving resulting from this sale of the bonds.

These averments of fact, and this indicated ground of relief are conclusive, so far as concerns the allegations of the complaint, against any argument by the plaintiff impeaching the validity or sufficiency of the sale of the bonds at par, expressly stated to have been authorized by the directors, unanimously ratified by the stockholders and availed of by complainant.

A sale thus recognized as valid cannot afford sufficient basis for the attack upon the Second Supplementary Contract as intended to protect such sale, nor for the subsequent allegation that the price at which the bonds were sold was very much below their then market value. The question as to whether the price was inadequate is a question of opinion, resting upon facts of which there are no allegations in the complaint. Manifestly, at the date of the Morgan contract, April, 1897, there was no market value for the bonds, for at that time no such bonds had ever been issued or sold, and none could be issued and made the subject of actual sale except concurrently with the retirement of

the Harlem Company's bonds, which would not become due until May 1, 1900, more than three years after the contract for sale. The contract of April, 1897, was not a present sale of bonds, but was a contract for their sale when they should be issued, and the allegation of the complaint that three years later, when the bonds were issued, "the syndicate associated with the purchasers sold the bonds to another syndicate at a premium of at least eight and one-half per cent., thereby securing a profit of \$960,000," is an allegation of fact having no tendency to show either that three years previously to such sale the bonds had a market value, or what the market value was at such earlier date.

In fine, it is clear that, to the extent of its allegations of fact, the complaint demonstrates that in October, 1898, the price of the bonds was not open to attack and that the protection of the sale at par could not have been the inducement to the execution of the Second Supplementary Contract in October, 1898.

## VI.

On the proposition that these minority stockholders of the Harlem Company have no standing in Court to object to the Second Supplemental Contract, except upon the ground of actual fraud, we call attention again to the decision of the Court of Appeals in the case of *Burden vs. Burden*, 159 N. Y., 287. In his oral argument, counsel for plaintiff has undertaken to distinguish that case from the one at bar, but, as we submit, unsuccessfully. What the Court held in that case is to be found in the opinion, at page 307 :

"It is undoubtedly a well-settled rule of law  
 "that executory contracts entered into by cor-  
 "porations having common directors are voidable  
 "at the instance of either corporation, and the

“ Court will not inquire into the question whether  
 “ or not it is beneficial to the corporation seeking  
 “ to avoid it.

“ This right is vested in the corporation and not  
 “ in the individual stockholder.

“ A stockholder cannot enjoin the execution of  
 “ a contract *intra vires* unless fraud is shown.

“ Morawetz on Corporations (§ 243) uses this  
 “ language: ‘ So long as the agents of a corpora-  
 “ ‘ tion act honestly within the powers conferred  
 “ ‘ upon them by the charter, they cannot be con-  
 “ ‘ trolled. The individual shareholders have no  
 “ ‘ authority to dictate to the company’s agents  
 “ ‘ what policy they shall pursue, or to impair  
 “ ‘ that discretion which was conferred upon them  
 “ ‘ by the charter.’

“ The rule is also laid down in *Leslie v. Loril-*  
*lard* (110 N. Y., 332). Judge GRAY, speaking  
 “ for the court, said: ‘ In actions by stockholders,  
 “ ‘ which assail the acts of their directors or  
 “ ‘ trustees, courts will not interfere unless the  
 “ ‘ powers have been illegally or unconscientiously  
 “ ‘ executed, or unless it be made to appear that  
 “ ‘ the acts were fraudulent or collusive and de-  
 “ ‘ structive of the rights of the stockholders.  
 “ ‘ Mere errors of judgment are not sufficient as  
 “ ‘ grounds for equity interference; for the powers  
 “ ‘ of those intrusted with corporate management  
 “ ‘ are largely discretionary.’

“ The plaintiff was not entitled to the injunc-  
 “ tion prohibiting further dealings with the Hud-  
 “ son River Ore and Iron Company.

“ The plaintiff is doubtless quite right when he  
 “ insists that he has been ignored in the manage-  
 “ agement of the Burden Iron Company, and has  
 “ no control, save to vote his stock, over proper-  
 “ ties of great value in which his interest is nearly  
 “ one-half, but he apparently fails to appreciate  
 “ that his troubles are inherent to the situation.

“ The plaintiff is in the position of all minority  
 “ stockholders who cannot interfere with the man-

“ agement of the corporation so long as the trustees are acting honestly and within their discretionary powers.”

Counsel for plaintiff has referred to the opinion of Judge VAN BRUNT in the *Metropolitan Case* (14 Abb. N. C., 103), as to which we have to say :

FIRST. Upon page 273, Judge VAN BRUNT, following *Wallace vs. Long Island R. R. Co.* (12 Hun, 460, 464), says :

“ The principle is here recognized that the majority of the shareholders may ratify a lease made by the directors and that a minority cannot disaffirm. That, therefore, it must be a majority of the shareholders acting through the corporation who repudiate, and no shareholder has the power to exercise that right against the will of the majority.”

SECOND. Judge VAN BRUNT's particular theory as to a director's contract with his corporation is by himself declared in the cases of *Beers vs. N. Y. Life Insurance Co.*, (66 Hun, 75-86), and *Nathan vs. Whitehill*, (67 Hun, 400), not to be the present law of this State. Such, also, was the opinion of Judge ADAMS in the *Genesee Valley Case*, (15 Misc., 187-195), and of Judge RUMSEY in *Strobel vs. Brownell*, (16 Misc., 657-660).

In the case of *Nathan vs. Whitehill*, *supra*, Judge VAN BRUNT says :

“ It seems to be assumed as the basis upon which this action proceeds, that, because the defendant Whitehill was a trustee of the corporation in which the plaintiff was a stockholder, therefore, he could not deal with such corporation. This theory, which has so long obtained in this State, seems to have been exploded by

“ the decision of the Court of Appeals in the case  
 “ of *Gamble v. Queens County Water Company*  
 “ (123 N. Y., 91).”

While not conceding the correctness of Judge VAN BRUNT's statement to the effect that the theory in question “long obtained in this State,” and without conceding that any such theory *ever* “obtained in this State,” it is certainly true that, if there ever was any such theory, it was “exploded” by the decision in the *Gamble* case.

## VII.

Upon the oral argument, one of the counsel for plaintiff reiterated the allegation repeated three times in the complaint (p. 14, fol. 41; p. 17, fol. 50; p. 20, fol. 60), that by the terms of the second supplementary contract the Central Company is relieved after May 1, 1900, from all obligations to continue the payment of the annual rental of \$840,000, the equivalent of seven per cent. interest on said consolidated mortgage bonds, and is required to pay only the sum of \$620,000, “thus entailing upon the Harlem Company a loss of “\$220,000 per annum for 374 years after May 1, 1900, “being a total amount for said period of \$82,280,000 “without additions of interest” (p. 14, fol. 42).

The emphasis of counsel's reiteration of this statement is equalled only by his moderation. The additions of interest, thus lightly disregarded, would have swelled the loss to a very impressive total. If the total annual loss of \$220,000 be computed at compound interest with annual rests for the period of 374 years, the total amount involved will be found to be upwards of **\$643,000,000,000,000**, which is the sum that, upon his theory, counsel might just as well have asserted to be the amount involved in this suit.

But, however, as matter of fact, this suit does not involve a sum either as vast as that stated by counsel, or as that which would result from the computation of \$220,000 per annum at compound interest. The principal sum involved cannot be larger than that which invested at three and one-half per cent. interest, would be sufficient, to produce \$220,000 per annum, which sum is \$6,285,714. The fallacy and extravagance of counsel's suggestion are practically exhibited by the fact that the \$10,000,000 Harlem stock, selling at 420, is \$42,000,000, so that the entire shareholders' interest is only about one-half the amount that counsel indicates as lost because the interest annually paid is \$620,000 instead of \$840,000 as desired by him.

Except for the remark interjected upon the oral argument, it would have been difficult to believe that even the thrice-repeated statement in the complaint was intended for serious consideration.

Counsel for plaintiff find some abstruse significance in the similarity in amount between this imaginary loss of \$82,280,000 to the Harlem Company and the amount of the principal of the new mortgage bonds of the Central Company.

It is averred in the complaint that

"said supplementary contract by the terms thereof reduced the rental obligation of the said Central Company under the terms of said lease in the said sum of \$82,280,000, an amount, without interest, nearly equal to the \$85,000,000 principal of the said Central Company's mortgage bonds purchased by said Morgan's firm, and with interest added, was greatly in excess of the principal of said Central Company's bonds purchased by said Morgan's firm" (fols. 60, 61, pp. 20, 21).

The significance of this supposed coincidence of figures we must confess ourselves quite unable to comprehend. It serves, however, to illustrate the straits to which plaintiff's counsel are driven in endeavoring to invent theories in support of the allegations of fraud brought against the directors of the Harlem Railroad.

If counsel had computed the number of lineal feet of main track and side track of the New York Central and Hudson River Railroad, they might possibly have discovered some further coincidence between the amount of the alleged loss to the Harlem Railroad and the dimensions of the Central's roadbed. What possible connection is there between the principal amount of the Central Company's new mortgage and the total amount of alleged loss to the Harlem Railroad by the second supplementary contract ?

As we have shown above, however, the computation by which counsel for plaintiff figures out this enormous loss of \$82,000,000 and upwards to the Harlem Company is fallacious and untenable ; and the alleged coincidence and any inferences that counsel may draw therefrom fall to the ground.

WM. B. HORNBLOWER,  
Of Counsel for Defendants.































## Supreme Court,

COUNTY OF NEW YORK.

CONTINENTAL INSURANCE COM-  
PANY,

Plaintiff,

AGAINST

NEW YORK AND HARLEM RAIL-  
ROAD COMPANY and NEW  
YORK CENTRAL AND HUDSON  
RIVER RAILROAD COMPANY,  
Defendants.

### PLAINTIFF'S REPLY TO SUPPLEMENTAL BRIEF OF THE DEFENDANTS' COUNSEL.

It is not intended in this reply to go over the matters touched upon in the first argument of the plaintiff's counsel, but simply to call attention to what seem to be obvious answers to suggestions submitted in the supplemental brief of the defendants' counsel, taking up the various points in the order in which they are presented by him.

## POINTS.

### I.

**The plaintiff's construction of the sixth clause gives sufficient effect to the second paragraph of that clause.**

Assuming that, except for the provisions of the Sixth Article, there could be no possible question that the Central Company was required by the terms of the First and Second Articles of the lease to pay as a portion of the annual rent the interest upon the twelve millions of dollars of consolidated mortgage bonds, it only remains to speak of the argument in the first and second points of the replying brief. The complaint of the counsel in those two points is that the argument of the plaintiff tends to render meaningless and purposeless the second half of Article Sixth of the lease. It probably would be more accurate if he had stated that the argument of the plaintiff's counsel tends to limit the application of Article Sixth to a condition of affairs which, under ordinary circumstances, was not likely to occur.

The argument of counsel for defendants is that the Harlem Company was without the right to borrow the money by the issue of new bonds with which to pay the Consolidated Mortgage Bonds. In the very same breath he insists that if the Consolidated Mortgage Bonds were paid by the Central Company, it was the duty of the Harlem Company to issue its bonds in reimbursement of the payment made by the Central Company. In other words, the Harlem Company was powerless to protect its own interests by borrowing money on its bonds, but bound to protect the interests of the Central Com-

pany by borrowing on its bonds. This is neither a sensible, reasonable nor just construction of the lease. When regard is had to the provisions of the Sixth Article relating to issue of bonds by the Harlem Company to reimburse the Central Company for moneys paid by it, it is plain that there was but one contingency in which the Central Company would have the right to call upon the Harlem Company to issue its new bonds, namely, when it, the Central Company, had paid the Consolidated Mortgage Bonds, a contingency which has never happened. Until that contingency happened the provisions of the Sixth Article of the lease providing for such issue were intended by both of the parties to the lease to be, and were, in fact, inoperative.

It is not precisely perceived wherein it is important that the necessity for action on the part of the Central Company under the second clause of the Sixth Article should arise. The meaning and intention of the first clause of that article, so far as the consolidated mortgage bonds are concerned, is very obvious to the plaintiff's counsel. It was certainly never intended by that clause that the Central Company should, at all events and under all circumstances, have the right or be called upon to pay those consolidated mortgage bonds when they fell due. That this is so is made positively certain by a consideration of the first part of the sixth clause. Two sets of bonds were referred to therein. As to one set there was an agreement on the part of the Central Company to pay them at maturity. This agreement was absolute and unconditional. If it had been intended that the Central Company should make the same agreement with respect to the consolidated mortgage bonds, nothing else would have been said about those bonds, because by leaving out the words "except the consolidated mortgage bonds" the absolute liability of the Cen-

tral Company to pay them would have been undoubtedly established. But those bonds were excepted from the absolute liability assumed by the Central Company. The words of that exception were that those bonds would be paid by the Central Company unless the Harlem Company should do so. What possible reason could there have been for that limited liability with respect to those bonds unless it was intended to provide only for a failure on the part of the Harlem Company to take care of them when they matured? Any suggestion that this covenant imposed upon the lessee the absolute and unqualified duty of taking care of those bonds in the first instance does violence not only to the express wording of the contract, but to the necessary construction of it, having in view the liability assumed by the Central Company in respect of the other bonds mentioned in that clause.

The reason of the insertion of the second clause in the sixth article is quite plain. The consolidated mortgage of twelve millions of dollars was a lien upon the property of the Harlem Road superior to the lease given to the Central Company in 1873. If those bonds should not be paid at their maturity the trustee could be compelled to foreclose the mortgage and thus cut off not only the title of the Harlem Road, but the leasehold interest of the Central. It was important the Central Company should have the right to protect that leasehold interest without undue expense to itself, and for that purpose not only was the limited right given to it to pay the bonds in case the Harlem Road did not take care of them, but a way was provided in which, *after the payment of the bonds*, the Central Company could reimburse itself by requiring new bonds of the Harlem Company. But it will be noticed that this second clause gives the right to the Central Company to have new bonds of the Harlem Company *only* in case it shall have paid the consolidated mortgage bonds. After

that, and not until that time, was the Central Company at liberty to call upon the Harlem Company to issue new bonds to enable it to repay itself for the money which it had paid. Until it had done that there could be no pretense that the Central Company had any right to call upon the Harlem Company for any issue of bonds.

It is not deemed necessary to recapitulate the suggestions contained in the first argument of the plaintiff's counsel in that regard. It is proper, however, in view of the argument of the defendants' counsel, to call the attention of the Referee precisely to the situation of affairs at the time when this alleged dispute arose.

It is conceded by this motion that a majority of the Central directors constituted a majority of the Board of Harlem directors. It is quite evident, therefore, that no act could be done by the Harlem directors without the consent of a portion at least of the members of the Board of Directors of the Central Company. It appears from the complaint that in May, 1897, at a meeting of the Board of Harlem Directors, at which, of course, a quorum must have been present, a *resolution was unanimously passed asserting the right of the Harlem Company to pay the consolidated mortgage bonds; to pay them by issuing new bonds secured by a new mortgage; and providing also that it should be done in such a way as not to increase the debt of the Harlem Company; and so that no more than twelve millions of dollars of bonds should be outstanding at any one time.* This could not have been done unanimously without the consent of a portion at least of the Central directors. It is important here to bear in mind that the allegation of the complaint is that a majority of the directors of the Central Company were a majority of the Board of Directors of the Harlem Company, and that said majority owned or controlled a majority of the stock of both companies and dominated

the policy or controlled the management of each company and the selection of officers and directors thereof. This undoubted fact is admitted by this motion.

So far as appears from the complaint, no objection was taken by the Central Board of Directors to these acts of the Harlem Board of Directors for a considerable time. Before any objection was taken the Harlem directors had submitted the question of the issue of these new bonds to the stockholders, and the stockholders, a majority of whose stock was owned or controlled by the directors of the Central Company, had unanimously voted to issue the new bonds, and those bonds had been sold by the Harlem Company to a syndicate of which J. P. Morgan & Company were the managers; and the mortgage had been executed, and the rights of the Harlem Company to receive the twelve millions of dollars to be obtained from these new bonds had accrued and was fixed. This was done before any objection was taken by the Board of Directors of the Central Company, so that before the Central Company had made any complaint of their own action as Directors of the Harlem Company, we find that the Harlem Company had taken steps to put itself in possession of the necessary twelve millions of dollars to pay these consolidated mortgage bonds, and had done so in such a way that the new mortgage to be issued was not a lien upon the leasehold interest of the Central Company, but that such interest had been entirely relieved from the burden and encumbrance of the consolidated mortgage.

We do not propose to argue again the proposition that this action was entirely within the powers of the Harlem directors. Indeed, at that time nobody seems to have questioned it. The only persons who ever did question it, so far as appears, were the same persons who did it. None of these things could have ever taken place without the action of the directors of the Central Company; and too much

stress cannot be laid upon that fact as bearing upon the good faith of the proceeding which was taken by the Central Company to set aside their own completed action as directors of the Harlem Company in the interests of that company.

## II.

**It is said by the counsel in his replying brief that there was a *bona fide* dispute between the two corporations as to the liability upon this lease.**

A few words may properly be said upon that point. The Harlem Company had issued the bonds, executed the mortgage, sold the bonds, and became entitled to twelve millions of dollars without any objection on the part of anybody. Indeed, not only was that done without any objection, but it was done by the express consent of a portion at least of the Central Board of Directors, without whose consent it never could have been done. The first that is learned of any dispute in respect of this matter is the action of the Central Company against the Harlem Company (being substantially the same people), conceded not to have been instituted in good faith or for the purpose of or with the intent of prosecuting the same to judgment, and conceded to have been commenced only for the purpose of discontinuing the same, and thereby furnishing a colorable excuse or pretended consideration for the so-called compromise and second supplementary contract. Not only was that action begun for that purpose, but it never was prosecuted to judgment. The intent to use it as a ground of compromise was carried out, and the result of this collusive action

was to give to the Central Company \$220,000 a year, which it actually owed to the Harlem Company. That this was done is conceded, and if the plaintiff's construction of this lease is correct it was clearly a waste of the assets of the Harlem Company to carry out a compromise of a colorable and pretended dispute which never had any existence except in the shape of an action brought for the express purpose of serving as a foundation for the compromise.

It is confidently submitted that the words of Judge BOCKES, quoted in the argument of the plaintiff's counsel from the case of *Farmers' Bank vs. Blair* (44 Barb., 641), are applicable to this pretended dispute, and that as a matter of law, upon the admitted facts, it could not afford any ground for any compromise whatever.

### III.

**Upon the question of fraud it is submitted that the whole transaction must be taken together.**

Defendant's counsel point to this fact and say that it does not constitute fraud; and the other fact and say that that does not constitute fraud; and the third fact and say that that does not constitute fraud. All that may be very true, but the plaintiff's contention is that the sum of the whole transaction was undoubtedly a surrender on the part of the directors of the Harlem Company of the rights of that corporation, in the interest and at the direction of the Central Company, the dominant of the two corporations; and that under the circumstances, taking the whole transaction together, it was fraudulent. It is strenuously insisted by the

defendant's counsel that the matter of the sale of the bonds was not in dispute. Look at the facts. The Harlem Company had been bound hard and fast by a contract to sell these bonds to the syndicate. This was done without any objection on the part of anybody. But the directors of the Central Company, who had done it, and had bound the Harlem Company by a contract the violation of which would have rendered the Harlem Company liable to serious damages, bring an action asserting upon untruthful allegations an unfounded right against the Harlem Company, and ask in the complaint that the issue of these bonds be restrained and prevented (Complt., fols. 37, 38). If that action was well founded, the only result of it could have been that the Harlem Company would have been subjected to a liability for damages, because it would have been compelled to violate its contract with the syndicate to sell these bonds; or it could only be relieved from those damages by yielding to the demands of the Central Company, whatever those demands might have been. Now, when it is recollected that the directors of the Central Company put the Harlem Company into this position and found no fault with their own action as directors of the Harlem Company until that company had been tied hand and foot by the bargain to issue and sell these bonds, and then put pressure upon the Harlem Company to take away its power to sell them, it certainly is not unfair to claim that so far as the directors of the two companies were the same persons they were not acting in the interest of the Harlem Company, but they were acting in the interest and for the benefit of the Central Company to squeeze out of the Harlem Company a pretended compromise of an undisputed right so that in that way the Harlem Company might be enabled to keep its contract to issue and sell the twelve millions of dollars of bonds and be relieved from a great burden of liability which the violation of that contract would impose upon it.

Considering this fact in addition to all the other facts which are so well stated in the sixth point of the original brief of the plaintiff's counsel, by Mr. Trull, there can be no doubt that to the extent at least that the Harlem directors abandoned their duty towards the Harlem Company and gave way unnecessarily and improperly to the claims of the Central Company they were guilty of fraud towards the company which they represented.

It is claimed that the sale of the Harlem bonds at par was ratified by the stockholders. This claim is based upon the fact that the resolution authorizing the issue of the bonds in its preamble recited that arrangements had been made to dispose of them at par. Now it is alleged in the complaint and admitted upon this motion, that the bonds were sold at  $103\frac{1}{2}$  and not at par and that out of the purchase price a commission was to be allowed to the purchasers of \$420,000. A commission admitted to be hundreds of thousands of dollars in excess of that for which responsible bankers would have undertaken the sale of the bonds, and that the price at which the bonds were sold was very much less than their market value. It is also alleged in the complaint and admitted, that a Syndicate composed of favored stockholders and Directors of the Harlem and Central Companies were interested in the purchase of the bonds. The circular to the stockholders failed to set forth or state those facts (Complaint, p. 15, fols. 43-44; p. 19, fols. 55-56).

In view of these facts and admissions the recital in the resolution authorizing the issue of the bonds, that they had been disposed of at par, cannot be construed as a ratification of the sale of the bonds, upon the terms as made and in the purchase of which favored stockholders and directors of the Harlem and Central Companies were interested.

## IV.

**The allegations of the complaint clearly make out a case authorizing the interference of the court at the suit of a minority stockholder.**

In the case of *Genesee Valley Railway Co. vs. The Retsof Mining Co.* (15 Misc., 187), the action was brought to restrain the Retsof Mining Company from taking possession of the railroad of the plaintiff. The facts showed that the defendant had assumed to take possession of the plaintiff's railroad, and was proposing to destroy it if necessary to prevent the plaintiff from having any benefit of it. The question before the Court was whether under the circumstances the defendant should be restrained from its summary proceeding to destroy the rights of the plaintiff. One of the reasons why the defendant claimed that an injunction should not be issued was that the original contract between the two companies in respect of the property, by virtue of which the plaintiff became entitled to it, was invalid. That invalidity was not because the directors of the two corporations were the same, but because the directors of the defendant were interested in the plaintiff's corporation (p. 193). It does not appear that they were common directors. Judge ADAMS held that the fact of an interest in the plaintiff's corporation afforded no ground for refusing an injunction (p. 194). No such question as is here presented was before him.

In *Wallace vs. Long Island Railroad* (12 Hun, 460), the same persons were directors of each of the companies, making the contract sought to be set aside. No effort had been made to procure action by the corporation. The contract was undoubtedly one within the power of the directors, and the Court held that it did not appear that the directors of the Long Railroad had abused their power, and there-

fore a stockholder could not sue to have the lease avoided.

The law laid down by Judge VAN BRUNT in *Beers vs. Insurance Co.* (76 Hun, 75, 86), is precisely in accordance with the law laid down by the later cases in this State.

In *Leslie vs. Lorillard* (110 N. Y., 519, 532), the rule laid down by Judge GRAY is precisely the one invoked by us, and we repeat it, although it is cited on the thirteenth page of the reply brief of the defendants. It is this:

“ In actions by stockholders, which assail  
 “ the acts of their directors or trustees, the  
 “ courts will not interfere unless the powers  
 “ have been illegally or unconscientiously ex-  
 “ ecuted, or unless it be made to appear that  
 “ the acts were fraudulent or collusive and  
 “ destructive of the rights of the stockholders.  
 “ Mere errors of judgment are not sufficient  
 “ as grounds for equity interference, for the  
 “ powers of those entrusted with corporate  
 “ management are largely discretionary.”

This rule is certainly broad enough to permit the plaintiff to maintain this action.

As the counsel has referred to the case *Stroebel vs. Brownell* (16 Misc., 657) we take the liberty to call the attention of the Court to the rule therein stated at pages 660 and 661, which we suppose to be the true rule now existing in this State. Our contention is substantially this: the cases cited on page 40 of the plaintiff's brief show clearly that this compromise agreement, made as it was by common directors, was voidable at the suit of the corporation. The facts admitted by this motion show clearly that this contract was unconscientious and a waste of the assets of the Harlem Company, and therefore destructive of the rights of the stockholders. The facts also show that the policy of the Harlem Company and the majority of its stockholders were controlled by the men who made this contract, and that not only would this company never bring an action

to set aside this contract, but that if there were a long delay the contract would be ratified by acquiescence and any right of anybody to set it aside would be entirely lost.

The cases cited on page 46 of the plaintiff's brief show clearly that upon this state of facts a minority stockholder is entitled to bring both corporations into court to have the propriety and fairness of this contract investigated.

The cases following, among many others, may be cited to show how far the courts of this and other States and the United States have scrutinized contracts or transactions of a corporation at the instance of minority stockholders, and granted the relief sought where it appeared that the contract or transaction was fraudulent, illegal, collusive or destructive to the rights of the corporation and the stockholders.

See

March *vs.* The Eastern Railway, 40 New Hampshire, 548; s. c., 43 New Hampshire, 515, 531, 532.

Wardell *vs.* Railway Company, 103 U. S., 651.

Higgins *vs.* Lansingh, 154 Ill., 301.

Cumberland Coal & Iron Co. *vs.* Sherman, 30 Barb., 553.

Richardson's Exec. *vs.* Green, 133 U. S., 30.

Pearson *vs.* Concord R. R. Co., 62 N. H., 537.

Fitzgerald *vs.* Fitzgerald, etc., Co., 41 Neb., 374.

Cook on Corporations, § 658 and cases cited, § 662 and cases cited.

Morawetz on Private Corporations, § 529 and cases cited.

Munson *vs.* S. G. & C. R. R. Co., 103 N. Y., 58, 73, 74.

In *March vs. Eastern R. R.*, *supra*, it was held that where the railroad of one corporation had been leased to another railroad company under an agreement by which the lessee guaranteed a fixed sum to the lessor, and the lessee company refused to fulfill its contract and has control of the lessor company, a minority stockholder of the lessor company may bring suit to remedy the wrong.

That case is very nearly in point and the Court went so far as to hold that to constitute an illegal application of the funds or money of a corporation, it is not necessary that there should be any intentional wrong or actual fraud, and that to give the Court jurisdiction in equity in such a case the plaintiff need not allege or prove any actual or willful fraud or collusion on the part of the company or companies, or the directors thereof.

In *Higgins vs. Lansing*, *supra*, which is a recent and well-considered case, a non-assenting stockholder was permitted to come in and set aside a settlement and adjustment between the corporation and its creditors. The creditors were in control of the corporation through a trustee who held a majority of the stock as security, with full power to vote it, and the settlement was made with the creditors by the board of directors, dominated and controlled by the trustees and creditors themselves. The settlement was set aside at the instance of a non-assenting stockholder, although no actual fraud appeared, and even though the Court below said that the settlement may have been, and in its opinion was, for the best interests of the corporation, at the time. The Court said (p. 368):

“On the contrary, it is held that the directors, without the sanction of the stockholders, have no power to contract for the corporation, with themselves, or for the benefit of themselves, and if they attempted to do so, the contract may be avoided by the corporation or its stockholders not assenting, whether the contract appears to be fair and just or not.”

This rule has been recognized in New York in *Met. El. R. R. vs. Man. R. R. Co.*, in 11 Daly, and numerous cases show that the principle that trustees cannot deal with themselves is universally applied to the directors of corporations. *Pearson vs. Concord R. R.*, *supra*; *Jewett vs. Miller*, 10 N. Y., 402; *N. Y. Ins. Co. vs. National Ins. Co.*, 20 Barb., 470; *Davone vs. Fanning*, 2 Johns., Ch. 252, and many other cases may be considered as establishing that doctrine beyond question.

In *Cumberland Co. vs. Sherman*, 30 Barb., 553, it was sought to set aside a contract and deed of sale of certain coal lands of the plaintiff to Sherman, one of its directors. The opinion is at Special Term on a motion to dissolve a preliminary injunction, but the motion was argued by some of the most eminent counsel then at the bar—C. A. Rapallo and Samuel J. Tilden for the motion and Luther R. Marsh and E. W. Shoughton opposed—and the opinion is learned and exhaustive. The case is said in *Port vs. Russell*, 36 Ind., 70, to be one of the three leading American cases on the subject of fraud by directors.

Speaking of the confirmation of the transaction, the Court said:

“But even if the confirmation had been  
 “legally made and by a majority of the  
 “stockholders, which it clearly was not,  
 “when, as in this case, it was to be made by  
 “a class, the sanction of a major part will  
 “not be obligatory on the rest, but the con-  
 “firmation to be complete must be the joint  
 “act of the whole body” (citing cases).

In *Fitzgerald vs. Fitzgerald & Mallory Co.*, *supra*, is found a state of facts in many respects similar to the present case. Plaintiff was a minority stockholder in the Fitzgerald & Mallory Construction Company, suing on behalf of himself and others similarly situated. It appeared that the Construction Company had a contract with the

Missouri Pacific Railroad Company to turn over bonds and stock of two other railroads which the Construction Company was building and to receive therefor bonds of the Missouri Pacific and certain traffic concessions. Subsequent to these contracts Jay Gould, who controlled the Missouri Pacific, secured a controlling majority of the stock of the Construction Company, and substituted for three of the five directors Messrs. George Gould, Sage and Dillon, who were his representatives and controlled by him and all of whom were directors of the Missouri Pacific. This majority of the directors, it appeared, were guilty of various acts having for their purpose the securing of the assets of the Construction Company by the Missouri Pacific and individuals, and particularly it appeared that the three directors who were a majority of the Board of Directors of the Missouri Pacific disposed of the Missouri Pacific bonds received by the Construction Company for building the roads to favored stockholders at ninety cents on the dollar, which was much less than their actual value. It also appeared that the directors borrowed \$2,500,000 from Gould, when more than that amount was due from the Missouri Pacific. It was held that the plaintiff could maintain the action and that no demand was necessary on the directors; and that no question of acquiescence of the Construction Company could arise, since the latter was dominated by the same individuals who dominated the Missouri Pacific, the Missouri Pacific was held liable for the discount at which the bonds were sold, and for the interest on the loan of \$2,500,000, paid by the Construction Company, on the theory that the wrongs were committed by the agents of the Missouri Pacific, the trial Court having found that all the acts of the common directors were in the interest of the Missouri Pacific. The trial Court had also found that the bonds were reasonably worth par.

The decree was modified in 44 Neb., 468 (1895), by

reducing the amount from \$700,000 to \$300,906, and the United States Supreme Court dismissed an appeal in *Mo. Pa. Ry. vs. Fitzgerald*, 160 U. S., 556.

In *Pearson vs. Concord R. R. Co.*, *supra*, a minority stockholder in the Concord R. R. Co. filed a bill to set aside certain traffic agreements between that company and the Boston, Concord & Montreal R. R. It appeared that the latter company had acquired control of a majority of the stock of the Concord Company, and that common directors had been elected who controlled the management of the Concord Company. It was held that the action was properly brought by the plaintiff and the agreements were set aside. No actual fraud was shown—in fact it appeared that the directors had acted honestly and fairly in the discharge of their joint duties, but that as a result of such directorship the income of the Concord Company had been diminished and that of the other companies increased. The decision was based upon the rule that a director is a trustee, and, standing in a fiduciary relation to the corporation, is subject to the disabilities of a trustee.

In *Munson v. S. G. & C. R. R. Co.* (103 N. Y., 73), the validity and inforcibility of a contract with the defendant corporation in which one of the directors of the corporation was interested and had taken part in procuring was considered. The Court, per Andrews, J., after stating that there was no evidence of any actual fraud or collusion on the part of any of the parties to the contract, or that the contract of assumption was induced by any improper appliances, states the rule which governs where the interest of the contracting parties are or might be in conflict, as follows: "The contract bound the corporation to purchase, and Munson, as one of the directors, participated in the action of the corporation in assuming the obligation, and in binding itself to pay the price primarily agreed upon between the plaintiffs and Magee. He stood in the attitude of selling as owner and purchasing

“ as trustee. The law permits no one to act in such  
 “ inconsistent relations. It does not stop to in-  
 “ quire whether the contract or transaction was fair  
 “ or unfair. It stops the inquiry when the relation  
 “ is disclosed, and sets aside the transaction or re-  
 “ fuses to enforce it, at the instance of the party  
 “ whom the fiduciary undertook to represent, with-  
 “ out undertaking to deal with the question of ab-  
 “ stract justice in the particular case. It pre-  
 “ vents frauds by making them as far as may  
 “ be impossible, knowing that real motives often  
 “ elude the most searching inquiry, and it leaves  
 “ neither to judge nor jury the right to deter-  
 “ mine upon a consideration of its advantages or  
 “ disadvantages, whether a contract made under  
 “ such circumstances shall stand or fall. It can make  
 “ no difference in the application of the rule in this  
 “ case, that Munson’s associates were not themselves  
 “ disabled from contracting with the corporation,  
 “ or that Munson was only one of ten directors who  
 “ voted in favor of the contract. The contract on  
 “ its face notified Munson’s associates of his rela-  
 “ tion to the corporation, and that the contract was  
 “ subject to be defeated on that ground, and on the  
 “ other hand a corporation, in order to defeat a  
 “ contract entered into by directors, in which one  
 “ or more of them had a private interest, is not  
 “ bound to show that the influence of the di-  
 “ rector or directors having the private ininter-  
 “ est, determined the action of the board. The  
 “ law cannot accurately measure the influence of a  
 “ trustee with his associates, nor will it enter into  
 “ the inquiry, in an action by the trustee in his  
 “ private capacity, to enforce the contract in the  
 “ making of which he participated. The value of  
 “ the rule of equity, to which we have adverted,  
 “ lies to a great extent in its stubbornness and in-  
 “ flexibility. Its rigidity gives it one of its chief  
 “ uses as a preventive or discouraging influence, be-  
 “ cause it weakens the temptation to dishonesty or  
 “ unfair dealing on the part of trustees, by vitia-

“ting, without attempt at discrimination, all  
 “transactions in which they assume the dual  
 “character of principal and representative.”

Citations could be multiplied indefinitely but the rule as stated by Cook and Morowetz in the sections cited, is amply supported by the authorities there cited and the foregoing cases. These authorities establish the rule that where corporations have common directors and, a minority of stockholders object to a contract between the corporations, the Court will consider the contract and sustain it if it is fair, and set it aside if it is unfair. Many of the cases go even beyond that, as in *Pearson vs. Concord R. R. Co.*, but at least that rule may be said to be well settled in American jurisprudence.

But it is not even necessary to go as far as that to render untenable the contention of the defendants in this case that the complaint does not make out such a case as would give a minority of the stockholders a standing in Court to attack the second supplementary contract. Clearly the allegations of the complaint make out a case of actual fraud, collusion and gross misapplication, and surrender of the corporate assets and rights of the Harlem Company such as could not be ratified against the objection of a single stockholder (see Point VI.). Even the cases cited by the defendants in this connection recognize that rule. In *Salem Iron Co. vs. Lake Superior Mining Co.*, 112 Fed. Rep., 239, the Court said, speaking of a contract between a corporation by its president with a firm of which the president was a member as agent for the seller:

“A contract so made was undoubtedly  
 “voidable and not void, unless the proofs  
 “should show that the conduct of the person  
 “acting in such dual relation amounted to  
 “fraud. This it might do if it were unfair  
 “and one-sided and palpably to the advantage  
 “of one party alone to the contract.”

*Burland vs. Erle*, Privy Council, Nov., 1901, App. Cases, 1902, Vol. 1, page 83, was a case in which a trustee and stockholder of the company had purchased certain property and sold it to the company at an enhanced price. The Court said:

“The cases in which a minority can maintain an action are confined to those in which the acts complained of are fraudulent in character or beyond the powers of the company.”

As the Court concluded that *Burland* was not acting in a fiduciary capacity in making the purchase, the decision is not in point in the present case, where there is no dispute that the directors were acting in their official capacity in making the contract.

In *Windmuller vs. Standard Distilling and Distributing Co.* (114 Fed. Rep., 491-494), the Court said:

“If the directors, who are the trustees of all, conspire with a few or some of the stockholders to deprive the others of their property the Court will interfere to see that justice is done. The Court will not permit the directors to divert the business of the corporation so that a sale and sacrifice of its assets will become obligatory and the distribution of the proceeds unequal among its shareholders.”

*Burden vs. Burden* (159 N. Y., 287) is sufficiently commented upon at page 45 of plaintiff's brief in opposition to this motion.

It was held in *Smyth vs. Ames*, 169 U. S., 466, that a stockholder in a railroad company may file a bill to enjoin an unreasonable reduction of the rates made by act of the Legislature.

It was held in *Pollock vs. Farmers' L. and T. Co.*, 157 U. S., 429 (1896) (158 U. S., 601), that a stockholder may enjoin his company from paying an illegal income tax.

It was held in *Weidenfeld vs. Sugar Run R. R.*, 48 Fed. Rep., 615 (1892), that a stockholder may enjoin a rival company from appropriating the right of way and property of his own company where a majority of the directors of his own company are allowing this to be done.

Clearly there can be no question upon the authorities that the minority stockholders of the Harlem Company have a standing in Court to attack the supplementary contract. In far less aggravated cases Courts of equity have invariably permitted a minority to be heard, and no case can be found in which relief has been refused to a minority where the transaction even remotely resembles that set forth by the complaint in this action.

## V.

**Upon this motion the only question presented to the Court is whether, in view of the admitted facts stated in the complaint and the well established rules of law, the plaintiff has set forth a cause of action,**

WILLIAM RUMSEY,  
WILLIAM C. TRULL,  
Of Counsel for Plaintiff.































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NEW YORK SUPREME COURT,  
COUNTY OF NEW YORK.

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CONTINENTAL INSURANCE COMPANY

*against*

NEW YORK AND HARLEM RAILROAD COMPANY AND NEW  
YORK CENTRAL AND HUDSON RIVER RAILROAD COMPANY.

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BEFORE THE HON. CHARLES ANDREWS, REFEREE,  
FEBRUARY, 1904.

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PLAINTIFFS' BRIEF AND ARGUMENT ON  
SUBMISSION OF CASE.

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JOHN G. MILBURN,  
WILLIAM C. TRULL,  
CHARLES E. MILLER,  
RICHARD L. SWEEZY,

*Of Counsel for Plaintiffs.*



## Supreme Court.

THE CONTINENTAL INSURANCE  
COMPANY

AGAINST

THE NEW YORK AND HARLEM  
RAILROAD COMPANY and THE  
NEW YORK CENTRAL AND  
HUDSON RIVER RAILROAD  
COMPANY.

Before  
Hon. CHARLES  
ANDREWS,  
Referee.

### BRIEF FOR PLAINTIFFS ON SUBMISSION OF CASE.

#### Statement.

The plaintiff and the intervening stockholders bring this action, as the owners of 12,329 shares of the stock of the defendant the Harlem Company, to set aside the second supplementary contract between the Harlem and Central Companies. By this contract the Central Company obtained a reduction of \$220,000 a year in the annual rent that it was bound to pay the Harlem Company by the terms of the lease of April, 1873, thereby involving a loss to the Harlem Company for the unexpired term of that lease, amounting, as stated by the Referee in his opinion, to the vast aggregate of upwards of \$82,000,000.

The extended discussion and argument, printed copies of which are herewith submitted, has fully

apprised the Referee of the grounds upon which the plaintiffs base their claim for relief.

In the opinion rendered, sustaining the complaint, it is decided "that the Harlem Company was entitled under the lease to issue new bonds secured by a mortgage on its reversionary interest in the railroad property to raise the money required to pay the consolidated mortgage bonds without the consent of the Central Company."

In the same opinion the Referee observes:

"If I am correct in my conclusion that the Harlem Company had the right under the lease to pay the consolidated mortgage bonds by its issue of three and one-half per cent. bonds without the consent of the Central Company, it is manifest that had it been permitted to carry out its intentions indicated by the action of its board of directors in May, 1897, it would be entitled to receive from the Central Company in each year after May 1st, 1900, during the continuance of the lease, the sum of \$840,000, and after paying thereout interest on the new bonds there would be left the sum of \$420,000 in each year for its general corporate purposes. By the supplementary contract this right was surrendered and the sum it was entitled to receive thereunder from the Central Company over and above the interest on the new bonds was \$200,000 a year. In other words, if the Harlem Company was right in its construction of the lease it lost by the compromise agreement \$220,000 a year for a term of 370 years, amounting in the aggregate to more than \$82,000,000, and the Central Company gained the same amount."

It is, therefore, the adjudged law of this case that the Harlem Company had the right, under the terms of the lease of 1873, to borrow money by the issue of new bonds to pay off the consolidated mortgage bonds, and upon such payment was thereafter entitled, during the unexpired term of the lease, to receive from the Central Company \$840,000 per annum as rental.

The defendants claim that the second supplementary contract, effecting the reduction in rental made under the circumstances disclosed by the evidence, is binding and conclusive upon the plaintiffs.

The plaintiffs deny the defendant's contention upon the following grounds:

## **POINTS.**

### **I.**

**Every material allegation of the complaint is established by the admitted facts and the evidence.**

(1.) The allegations contained in paragraphs of the complaint numbered I. to IX., inclusive, are not and never have been in dispute between the parties to the action, and are all substantiated by the admissions in the stipulation as to facts.

(2.) The truth of the allegation in paragraph IX. of the complaint to the effect that the Harlem Company was advised by its counsel that it was its right to pay off the consolidated mortgage bonds by the issue of new bonds does not admit of question. Such advice is admitted by the answer of the Harlem Company (fol. 14); such advice is recited in the circular issued to the Harlem stockholders, quoted at length in the answer of the Harlem Company (fol. 84); such advice is also admitted, though not as of the date stated in the complaint, by the defendants at page 6 of defendants' argument, "Reply and case on final submission," where counsel states: "It does appear "that subsequently, and after litigation between "the two companies had been instituted, Mr. Stetson and Mr. Joseph H. Choate were retained as "counsel for the Harlem Company in that litigation."

“tion, and, giving the plaintiffs the benefit of that  
 “fact, we have the circumstance that subsequently  
 “to (and not on or shortly before) April 14, 1897,  
 “the Harlem Company was advised by its counsel  
 “that the construction of the lease now contended  
 “for by plaintiffs was the true construction.”

(3.) The allegation in paragraph XIII. of the complaint, that the value of the railroad properties demised by the lease had increased in value was admitted by counsel. Mr. Hornblower in his argument upon the motion to dismiss the complaint at page 113 says, speaking of the lease: “Well, of  
 “course, it had a large value; of course it has doubt-  
 “less increased in value during the term which has  
 “elapsed since 1873.”

The allegations in the same paragraph of the complaint, that the Central Company would pay the rental which it has heretofore paid and now pays rather than terminate the lease is established by the admissions of the defendant The Central Company (Answer of Central Company, fol. 15), where it is stated “The Central Company is able and intends  
 “to fully keep and perform all the covenants, con-  
 “ditions and terms of the said lease as amended by  
 “the second supplementary contract or as the said  
 “lease is finally judicially construed.”

(4.) The allegation in paragraph XIII. of the complaint that a majority of the Board of Directors of the Central Company constituted a majority of the Board of Directors of the Harlem Company is not disputed. The further allegation in that paragraph that such majority owned or controlled a majority of the stock of both companies and dominated the policy and controlled the management of each; and the selection of officers and directors thereof, is established beyond question.

It is admitted that during the entire period covered by the transactions set forth in the complaint a majority of the directors of the Central Company con-

stituted a majority of the directors of the Harlem Company. The common directors of the two companies, during that period were the following named persons (Stipulation, pp. 4, 5, Arts. 3, 4):

Cornelius Vanderbilt,  
W. K. Vanderbilt,  
F. W. Vanderbilt,  
Samuel F. Barger,  
Chauncey M. Depew,  
Charles C. Clarke,  
Samuel D. Babcock,

except that on September 12, 1899, Cornelius Vanderbilt ceased to be a director of the Harlem Company, and on September 19, 1899, H. McK. Twombly, his brother-in-law and a director of the Central Company, was elected in his place. These directors, constituting as they did a majority of the Harlem Board, of course dominated the policy and controlled the management of that company. Not only did Central directors constitute a majority of the directors of the Harlem Company, but also the executive offices of the Harlem Company were filled by Central directors, and Central directors constituted the membership of the Finance and Executive Committee of the Harlem Company (Minutes, Exhibit 5, pp. 47-49).

During the years 1896, 1897, 1898 and 1899, Cornelius Vanderbilt, a Central director, was president of the Harlem Company; Charles C. Clarke, a Central director, was vice-president, and Edward V. W. Rossiter, secretary and treasurer of the Central Company, held like offices in the Harlem Company. During the same period William K. Vanderbilt, Frederick W. Vanderbilt, Chauncey M. Depew, Cornelius Vanderbilt and Charles C. Clarke, all directors of the Central Company, constituted the Executive and Finance Committee of the Harlem Company. The only member of that Committee during those years not a director of the Central Company was John B. Dutcher.

On September 19, 1899, H. McK. Twombly, a Central director, was elected a director of the Harlem Company in place of Cornelius Vanderbilt, who died September 12, 1899, Mr. Twombly was also appointed a member of the Executive and Finance Committee of the Harlem Company in place of Mr. Vanderbilt, and William K. Vanderbilt was elected president in place of Cornelius Vanderbilt (Minutes, p. 49).

On May 21, 1900, W. K. Vanderbilt was elected president, Charles C. Clarke, vice-president, and Edward V. W. Rossiter, secretary and treasurer of the Harlem Company, and William K. Vanderbilt, Frederick W. Vanderbilt, Samuel F. Barger, Chauncey M. Depew, John B. Dutcher and Charles C. Clarke constituted the Executive and Finance Committee, all except Mr. Dutcher being directors of the Central Company (Min. p. 49).

The Executive Committee was clothed with power to control, direct and manage the business of the company and to execute and affix the seal of the company to all agreements or leases which might from time to time require the seal of the company (Minutes, p. 50).

During the entire period covered by the transactions set forth in the complaint substantially all the stock voted at annual meetings was voted by proxies, and such proxies were directors of the Central Company (Minutes, p. 15).

It is manifest from this review of the evidence that directors of the Central Company, who were also directors of the Harlem, dominated the policy and controlled the management of the Harlem Company, as alleged in the complaint.

(5) The allegation in Paragraph XIII. of the complaint, that the financial interests of the Central directors, who were also directors of the Harlem Company, was larger in the Central Company than in the Harlem Company, is also established by the

evidence, with the exception of Cornelius Vanderbilt and Mr. Clarke.

This allegation had reference to the interests of these directors in the Central Company as stockholders of that company and as being interested in the Morgan Bond Syndicate.

The directors of the Central Company shown by the evidence to have been interested in the Morgan Bond Syndicate are the following:

Samuel D. Babcock, Chauncey M. Depew, Samuel F. Barger and Frederick W. Vanderbilt (Stip., pp. 30-32; fols. 116, 119, 120, 121).

William K. Vanderbilt was also interested in the Central bonds, having purchased those bonds to the amount of \$5,000,000 for himself and others from the syndicate managers, J. P. Morgan & Co. (Stip., p. 110).

On April 14, 1897, William K. Vanderbilt held 12,718 shares of Harlem stock and 12,000 shares of Central stock (Minutes, p. 123, Defendants' Exhibit A, December 27, 1903).

His Central stock at par was \$1,200,000, and his Central bonds \$5,000,000, making his Central interests \$6,200,000.

The value of his Harlem stock at its market price of 300 per cent., or \$150 per share, was \$1,907,700, and of his Harlem bonds at face value, \$1,000,000, making the total value of Harlem stock and bonds \$2,907,700, being \$3,292,300 less than his interest in the Central Company.

On the same date F. W. Vanderbilt held 100 shares of Harlem and 1100 shares of Central stock, the value of his Harlem holdings at the market price being \$15,000, and of his Central holdings at par, \$110,000. This is exclusive of his interest in the Morgan Bond Syndicate, as hereinafter stated.

On the same date S. F. Barger held 100 shares of Harlem stock and 200 shares of Central, his Harlem holdings being \$15,000, and his Central holdings \$20,000.

On the same date S. D. Babcock held 100 shares of Central stock and none of Harlem.

On the same date C. M. Depew held 200 shares of Harlem stock and 11 shares of Central, his interest in Harlem at the market value being \$30,000, and in Central at par, \$1,100.

Each of these directors of the Harlem Company is shown to have had an interest in the Morgan Bond Syndicate. By the terms of the Morgan Syndicate Agreement 11/91 of every subscription represented Harlem bonds and 80/91 represented Central bonds (Stip., p. 112).

Mr. Depew was interested in the subscriptions to the Morgan Bond Syndicate as director and stockholder of the Equitable Life Assurance Society, and director and stockholder of the Union Trust Company (Stip., p. 31, fol. 19).

The total of the subscriptions of these corporations to the Morgan Syndicate Agreement was \$3,000,000 (Stip., p. 29), of which subscription 80/91 represented Central bonds to the amount of upwards of \$2,367,360, and 11/91 Harlem bonds to the amount of upwards of \$362,637.

Mr. Babcock was a trustee and stockholder of the Central Trust Company, director and stockholder of the Guaranty Trust Company, a director and stockholder of the American Exchange Bank, a director and stockholder of the National Union Bank, a director and stockholder of the Bank of New Amsterdam, and a special partner in the firm of Hollister & Babcock, each subscribers to the Morgan syndicate agreement (Stip., p. 30, fols. 116-117). The total of the subscription of these corporations to the Morgan syndicate agreement was \$7,300,000 (Stip., p. 28, fols. 108-111), of which subscriptions 80/91 represented Central bonds to the amount of upwards of \$6,400,000, and 11/91 Harlem bonds to the amount of upward of \$882,000.

Samuel F. Barger was a director and stockholder of the Union Trust Company (Stip., p. 31, fol. 120), which was a subscriber to the Morgan syndicate

agreement in the amount of \$1,000,000 (Stip., p. 29, fol. 109), 80/91 of which, amounting to upwards of \$879,000, represented Central bonds, and 11/91, amounting to upwards of \$120,000, represented Harlem bonds.

Frederick W. Vanderbilt was a director and stockholder of the Guaranty Trust Company, a subscriber to the Morgan syndicate agreement (Stip., p. 32, fol. 121). The amount of the Guaranty Trust Company's subscription was \$500,000 (Stip., p. 21, fol. 109), 80/91 of which, amounting to upwards of \$439,000, represented Central bonds, and 11/91 of which, amounting to upwards of \$60,000, represented Harlem bonds.

On June 28, 1898, the date of the meeting of the Harlem directors for the appointment of the committee for the adjustment and settlement of alleged controversies (Stip., p. 217), the interest of the various directors in the Bond Syndicate and in Harlem and Central stock was the same as above, with the exception that W. K. Vanderbilt had increased his holdings in Central stock from 12,000 to 48,000 shares, and that F. W. Vanderbilt had increased his holdings in Central stock from 1,100 to 2,500 shares, and that S. D. Babcock was the owner of 50 shares of Harlem stock.

At the meeting of the Executive Committee of the Harlem Company on April 4, 1900 (Stip., p. 495), at which the execution of the second supplementary contract was authorized, the holdings of the directors of the Harlem Company in the Central and Harlem stock, and their interest in the Bond Syndicate so far as it related to Central bonds, was the same as last above mentioned, except that F. W. Vanderbilt had increased his holdings of Central stock from 2,500 shares to 2,875 shares (Stip., p. 495).

It is clear from the foregoing review of the evidence, that the allegation of the complaint as to the financial interests of the common directors in the

Central Company is sustained thereby, with the exception of Cornelius Vanderbilt and C. C. Clarke.

(6) The allegation in Paragraph XIV. of the complaint in this action (fol. 39) to the effect that the complaint in the action of the Central against the Harlem Company "untruthfully alleged that the issue of new first mortgage bonds would increase the indebtedness of the Harlem Company beyond \$12,000,000, it being well known to the said Central Company, its officers and Board of Directors, that the resolution authorizing the execution of said new first mortgage and the issue of said bonds, and the said mortgage specially provided against any increase of the bonded indebtedness of the said Harlem Company," is completely established.

The allegation in the Central complaint is to be found in Paragraph XXVII. This paragraph, after stating that if the defendant company shall carry out its intention of issuing the new bonds, or shall, except as requested by the plaintiff, make any new mortgage and issue new bonds thereunder, alleges that such new bonds "will wrongfully increase the bonded indebtedness of the defendant company." Here is a distinct allegation that the proposed new mortgage of the Harlem Company and the bonds proposed to be issued thereunder will increase the mortgaged indebtedness of the Harlem Company. This allegation lay at the foundation of the Central Company's right of action. It was made to establish a violation by the Harlem Company of the provisions of Article V. of the Lease. It was an untruthful allegation, and must have been known to be so at the time it was made. Upon this point there can be no possible question, for the reason that annexed to the complaint and forming part thereof, were the resolutions of the Harlem Company of April 14, 1897, wherein and whereby it was specially provided that "the new bonds shall be issued, certified, used and delivered exclusively for the simultaneous payment and satisfaction from

time to time of at least an equal amount of CONSOLIDATED MORTGAGE BONDS of the Railroad Company" (Stip., p. 85).

The resolutions of the Harlem Company thus guarding carefully against the increase of the bonded indebtedness of that company are annexed to the complaint of the Central Company and marked Exhibit C (Central Co. Complaint, Paragraph XVIII, p. 19, Exhibit C thereunto annexed).

The action of the Central Company against the Harlem Company was commenced on June 29, 1897 (Stip., Article XVIII., p. 14).

Prior to that date the Central Company was advised that the resolutions authorizing the issue of the new bonds and the mortgage securing the same specially provided that no new bonds should be issued except upon the simultaneous retirement of an equal amount of CONSOLIDATED MORTGAGE BONDS. The Central Company received this notice and acquired this knowledge as early as May 18, 1897, nearly a month and a half prior to the commencement of the action and the service of the complaint containing the untruthful and very material allegation. Reference to the minutes of the meeting of the Central Company held May 18, 1897, will disclose that at that meeting the resolution of the Harlem Company restricting the issue of the new bonds, as above mentioned, to the simultaneous retirement of an equal number of Harlem bonds, was communicated to the Central Company directors and annexed to the resolution adopted by the Board of Directors of the Central Company on that day (Stip., p. 117).

Not only was the Central Company advised of the untruthfulness of this allegation as to an increase of bonded indebtedness by the resolution annexed to its complaint and the communication made to it at this meeting of May 18, 1897, but it also had knowledge prior to the commencement of its action of the execution of the mortgage by the Harlem Company to the Guaranty Trust Company to secure

the new issue of bonds, and presumably had notice of the contents of that mortgage as is evidenced by its protest to the New York Guaranty Trust Company.

This protest is dated June 29, 1897, and was served on that date (Stip., p. 209).

The provision in the mortgage restricting the issue of new bonds is quite as explicit as that in the resolution authorizing their issue, and negatives any possible increase of the bonded indebtedness of the Harlem Company. In paragraph XXII. of the Central complaint the allegation is: "That the Harlem Company is about to make and execute and deliver to the Guaranty Trust Company as trustee a mortgage without the discharge of the mortgage made by the defendant company to the Union Trust Company of New York, made May 1, 1872, to increase beyond \$12,000,000 the bonded indebtedness of the defendant company to be secured by the aforesaid mortgage." The restriction in the new mortgage with reference to the issue of the new bonds is as follows: "Which bonds from time to time shall be issued, certified, used and delivered exclusively for the simultaneous payment and satisfaction from time to time of at least an equal amount of CONSOLIDATED MORTGAGE BONDS."

So careful was the Harlem Company that the new issue of bonds should not increase the bonded indebtedness of that company that in the resolution authorizing the issue of the new bonds they expressly provided that it was made "an essential condition of the issue of every such new mortgage bond that at no time shall there be authorized, issued and outstanding more than \$12,000,000 principal of bonds of the New York and Harlem Railroad Company, including the principal sum of all outstanding and unpaid CONSOLIDATED MORTGAGE BONDS" (Stip., p. 83).

This resolution is annexed to the complaint in the suit of the Central against the Harlem Company, was communicated to its Board of Directors at the

meeting held May 18, 1897, and establishes beyond all possible question the truth of the allegation of the complaint in this action of the untruthfulness of the allegation in the complaint in the Central's action, that the proposed new issue of bonds would increase the bonded indebtedness of the Harlem Company.

The fact that the resolutions containing these restrictions on the issue of the bonds was annexed to the complaint of the Central Company in its suit against the Harlem Company, and was communicated to the Central Board of Directors prior to the commencement of that action, also establishes beyond all possible question that the Central Company had knowledge of the untruthfulness of its allegation that the proposed new issue of bonds would increase the bonded indebtedness of the Harlem Company.

(7) The allegation in the complaint in this action (fols. 30-40) that the complaint in the Central suit against the Harlem Company untruthfully alleged that the Harlem Company "had no means of retiring and paying said \$12,000,000 consolidated mortgage bonds, except by issuing the said mortgage to the Guaranty Trust Company of New York, and the bonds in said mortgage provided for, or the issue of a similar mortgage and bonds," is clearly established by the evidence.

It appears by the evidence of Mr. Crane and the statement submitted by him, that on April 1, 1897, the available assets of the Harlem Company were \$2,865,783.10. By June 30, 1897, these available assets had been increased \$97,000, and by June 30, 1898, the available assets were further increased \$120,000, and that on September 30, 1899, the available assets were \$3,241,321.92 (Minutes, pp. 44-45).

It also appears that in 1896 the Harlem Company leased its street railroad to the Metropolitan Street Railway Company for an annual rental of \$350,000,

which, at the end of five years, was to be increased to \$400,000.

It further appears that during this period its stock was selling at a premium of 300 per cent. of par, and its new 3-1/2 per cent. bonds were sold by the Morgan Syndicate at a premium of 8-1/2 in 1898, to Harvey Fisk & Sons in a single block of \$11,000,000, and in 1899, when offered to the public, the bonds sold at 115.82 and interest (Minutes, p. 23, Exhibit 3).

(8) The allegation in Paragraph XVI. of the complaint that the second supplementary contract was authorized and approved by votes of directors of the Central Company who, at the same time, were directors of the Harlem Company, and by votes of certain directors of the Harlem Company who were interested in the contract for the purchase of the bonds of the Harlem Company and in the purchase of the bonds of the Central Company, is also established by the evidence.

At the meeting of the Executive Committee of the Harlem Company, held on April 4, 1900, there were five directors present. Of these, C. M. Depew, F. W. Vanderbilt and Samuel F. Barger were directors of the Central Company and interested in the contract for the purchase of the Central and Harlem bonds in the manner and amount previously stated. Another director present was Mr. Twombly, who was a director of the Central Company.

At the meeting of the directors of the Harlem Company on September 19, 1900, at which the action of the executive committee was ratified and confirmed, there were present nine directors, of whom the following were directors of the Central Company, namely: W. K. Vanderbilt, J. Pierpont Morgan, Chauncey M. Depew, Charles C. Clarke and Samuel D. Babcock and Edward V. Rossiter, secretary and treasurer of the Central Company, leaving only two directors present, namely, Dutcher and

Stillman, who were not connected with the Central Company. Of the Central directors, Messrs. W. K. Vanderbilt, Chauncey M. Depew, Charles C. Clarke and Samuel D. Babcock, were interested in the contract for the purchase of the Central and Harlem bonds in the manner and amount previously stated. Mr. Morgan was a member of the firm of J. P. Morgan & Co. and J. S. Morgan & Co., the syndicate managers, and of the firm of Morgan, Harjes & Co., all subscribers to the syndicate agreement (Stip., p. 36, fol. 115). The amount of their subscriptions to the syndicate agreement was as follows (Stip., p. 28-29, fols. 108-110):

J. P. Morgan & Co.....	\$14,000,000
J. S. Morgan & Co.....	10,925,000
Morgan, Harjes & Co.....	1,000,000
<hr/>	
Total.....	\$25,925,000

Of this amount 80/91 or upwards of \$22,800,000, represented Central bonds, and 11/91 thereof, amounting to upwards of \$3,000,000, represented Harlem bonds.

(9) The allegation of the complaint that the purchasers of the Harlem bonds represented and associated with themselves a syndicate composed in part of certain stockholders of the Harlem Company, and certain of the directors of the Harlem Company were also members of or interested in said syndicate, is fully established. It is admitted that certain of the stockholders of the Harlem Company were permitted to subscribe to the syndicate agreement (Stip., p. 30, fol. 114). It is admitted that William K. Vanderbilt was interested in the purchase of the bonds of the Harlem Company to the extent of \$1,000,000, and of the Central Company bonds to the extent of \$5,000,000.

It cannot be disputed that Samuel D. Babcock, Chauncey M. Depew, Samuel F. Barger and Fred-

erick W. Vanderbilt, directors of the Harlem Company, were interested in the Morgan Syndicate in the manner and to the extent previously stated.

Other stockholders of the Harlem Company who were interested are the following: Charles Lanier, Charles S. Smith, William D. Sloane, Samuel Thorne. They were interested as being directors and stockholders in corporations or members of firms subscribing to the syndicate agreement (Stip., fols. 116, 118, 119, 122, 123).

(10.) The allegation of the complaint in this action (fol. 57) that the commission exacted by the purchaser of the Harlem bonds of \$420,000 was excessive is sustained by substantial evidence.

The same persons who made this purchase sold \$11,000,000 of the same bonds to a second syndicate a little more than a year after at a premium of  $8\frac{1}{2}$  per cent., less a commission of one-half of one per cent., being one-seventh of the commission paid by the Harlem Company.

It is the undisputed evidence in this case that the Harlem bonds were an investment security of the highest and most desirable character, as is evidenced by the fact, among others, that they were eagerly subscribed for by the most reputable financial institutions and when first offered to the public months before their issue sold at a premium ranging from  $112\frac{1}{4}$  and interest to 115.82 and interest (Minutes, p. 23, Plaintiff's Exhibit 3).

It is in evidence, too, that early in 1897 Speyer & Co., responsible bankers, contracted to purchase \$50,000,000 Lake Shore  $3\frac{1}{2}$  per cent. gold bonds at 101, less a commission of only one per cent. Here, on a purchase of bonds in no sense superior to the Harlem bonds, responsible bankers took \$50,000,000 and charged a commission  $2\frac{1}{2}$  per cent. less than the Harlem bond commission.

(11.) The allegation that the Harlem bonds were sold below their market value, since they netted the

Harlem Company only par, is established by the same evidence which discloses that the commission exacted was excessive.

A commission of one-half per cent., the same as Harvey Fisk & Sons received, would have made the bonds net the Harlem Company, at the price bid by the Syndicate of  $103\frac{1}{2}$ , a premium of \$360,000.

A commission of one per cent., being the commission received by Speyer & Co. on the purchase of \$50,000,000 Lake Shore  $3\frac{1}{2}$  per cent. bonds, would have made the Harlem bonds net that company a premium of \$300,000.

(12.) The further allegation of the complaint (fol. 58) that had the Harlem bonds been offered to their stockholders at par every penny of premium realized by the syndicate would have been realized by the Harlem stockholders is clear from the evidence. The only answer attempted to be made to the truth of this allegation is, that there is no evidence that the Harlem stockholders would have subscribed for the bonds. The proof is positive and uncontradicted, on the other hand, that favored stockholders of the Harlem Company did subscribe to, and as members of firms were interested in the subscription to nearly one-half of the \$12,000,000 of Harlem bonds sold.

William K. Vanderbilt, a Harlem stockholder, took \$1,000,000 of the issue for himself and others.

The Mutual Life Insurance Company, a stockholder of the Harlem Company, subscribed to the Morgan Syndicate Agreement \$6,000,000, 11/91 of which, amounting to upwards of \$725,000, represented its subscription to Harlem bonds.

The United States Trust Company, a Harlem stockholder, subscribed to the Morgan Syndicate Agreement \$3,750,000, 11/91 of which, amounting to upwards of \$453,000, represented its subscription to Harlem bonds.

The Union Trust Company, a stockholder of the Harlem Company, subscribed to the Morgan Syndi-

cate Agreement \$1,000,000, 11/91 of which, amounting to upwards of \$120,000, represented its subscription to Harlem bonds.

Strong, Sturgis & Co., Harlem stockholders, subscribed to the Morgan Syndicate Agreement \$400,000, 11/91 of which, amounting to upwards of \$48,000, represented its subscription to Harlem bonds.

The Morristown Trust Company, a Harlem stockholder, subscribed to the Morgan Syndicate Agreement \$100,000, 11/91 of which, amounting to upwards of \$12,000, represented its subscription to Harlem bonds.

The firms of J. S. Morgan & Co., Morgan, Harjes & Co., and J. P. Morgan & Co., in which J. P. Morgan, a stockholder of the Harlem Company, was a member, subscribed to the Morgan Syndicate Agreement \$25,925,000, 11/91 of which, amounting to upwards of \$3,000,000, represented subscription to the Harlem bonds.

Winslow, Lanier & Co., of which firm Charles Lanier, a stockholder of the Harlem Company, was a member, subscribed to the Morgan Syndicate Agreement \$1,000,000, 11/91 of which, amounting to upwards of \$120,000, represented subscription to the Harlem bonds.

The total of these subscriptions to Harlem bonds made by Harlem stockholders, or by firms of which Harlem stockholders were members, amount to upwards of \$5,478,000, nearly fifty per cent. of the total \$12,000,000 issue of Harlem bonds.

More convincing evidence of the truth of the allegation of the complaint could not be adduced.

## II.

**The second supplementary contract was the consummation of a pre-arranged plan to create a dispute as**

**to the construction of the lease of 1873, and then compromise it by dividing the saving of interest effected by the issue of the new bonds at a lower rate of interest than the consolidated mortgage bonds.**

(a.) The evidence in support of the contentions here made is positive and convincing.

The plan to create a dispute and then compromise was formulated as early as 1897.

In December, 1896, Mr. Twombly was advised by Mr. Stetson that, under the terms of the lease of 1873, the Harlem Company had a right to pay off the consolidated mortgage bonds by the issue of new bonds at a lower rate of interest, and was entitled to the entire saving in interest resulting from such action.

In April, 1897, Mr. Twombly again applied to Mr. Stetson for advice.

On April 9, 1897, Mr. Stetson in reply to the inquiry of Mr. Twombly, advises him in substance and effect as follows (Stip., pp. 6-59):

(1.) That the Board of Directors of the Central Company may compromise any claim against the Harlem Company concerning the proposed action of that company indicated by the resolutions which he stated he prepared.

(2.) That the Board of Directors of the Harlem Company acting according to their best judgment may resist any claim the Central Company may make. Expressing doubt, however, whether the Harlem Company, like the Central Company, can act without the consent of its stockholders.

(3.) He then suggests as a basis of a compromise, a division between the two companies of the saving of interest effected by the issue of new bonds, in consideration of a guarantee by the Central Company of the new bonds.

(4.) He further suggests that except upon such a consideration any concession by the Harlem Company would be a surrender of its absolute rights.

(5.) He further suggests that if a compromise is to

be adopted it would be well to modify the resolutions prepared and submitted by him, since as they stand they would commit the Harlem directors to an absolute theory inconsistent with compromise.

He concludes his suggestions with the advice that the resolutions, when modified and adopted, should be communicated to the Central directors (Stip., pp. 59-61).

The resolutions referred to in Mr. Stetson's letter of advice outlining the plan for a dispute and compromise were the resolutions adopted by the Harlem Company at the meeting of April 14, 1897, asserting the right of the Harlem Company to pay off the consolidated mortgage bonds and to receive thereafter an annual rental of \$840,000, the equivalent to seven per cent. interest on those bonds. Thus, as early as April 9, 1897, a plan is outlined and suggested by which the Harlem Company is to be deprived of the full benefit to be derived from refunding the consolidated mortgage bonds at a lower rate of interest.

The resolutions of April 14, 1897, which committed the Harlem Company absolutely to the assertion of its right to pay off the consolidated mortgage bonds, were communicated to the Central Company's directors (Stip., p. 117).

At the meeting of April 14, 1897, of the directors of the Harlem Company, there were present nine directors, of whom four—William K. Vanderbilt, Frederick W. Vanderbilt, Chauncey M. Depew and Samuel F. Barger—were directors of the Central Company, and E. V. W. Rossiter, who was secretary and treasurer of the Central Company. Each of these directors voted for the resolution, asserting the right of the Harlem Company to pay off the consolidated mortgage bonds, and to the saving of interest resulting therefrom.

On April 21, 1897, Mr. Twombly was elected a director of the Central Company.

On May 18, 1897, a meeting of the Board of Di-

rectors of the Central Company was held, and in further execution of the plan to create a dispute the following proceedings were had: Resolutions were adopted denying the right of the Harlem Company to pay off the Consolidated Mortgage Bonds and denying its right to any saving of interest effected thereby. Resolutions to this effect were offered by Mr. Twombly, and a suit by the Central Company against the Harlem Company to restrain the issue of the bonds by the Harlem Company, was authorized.

At this meeting of the Central Company's directors ten directors were present, of whom the following were also directors of the Harlem Company; Chauncey M. Depew, Charles C. Clarke, William K. Vanderbilt, Frederick W. Vanderbilt and Samuel D. Babcock. At this meeting Mr. Twombly, to whom Mr. Stetson had addressed his letter outlining the plan of a dispute and compromise, offered preambles and resolutions which, after reciting that the Central Company had been informed of the action taken by the Board of Directors of the Harlem Company on April 14, 1897, insisting upon its right to the entire saving of \$420,000 to be effected by the refunding of the Consolidated Bonds, and further reciting that the claim was in the highest degree unjust, declared that the Harlem Company had no right to make any new mortgage without the request of the Central Company, and closed with the suggestion that the resolutions be communicated to the Harlem Company and that an action be immediately commenced to protect the rights of the Central Company; which resolution was adopted by the affirmative vote of each of the directors present, including C. C. Clarke, William K. Vanderbilt, Frederick W. Vanderbilt and Mr. Depew, who, on the 14th of April, 1897, had, as directors of the Harlem Company, voted for resolutions asserting just the contrary and affirming the right of the Harlem Company to the entire saving of interest (Stip., p. 116 *et seq.*; p. 80 *et seq.*).

Neither at the meeting of the Harlem Company held on April 14, 1897, nor at the meeting of the Central Company held on May 18, 1897, would there have been a quorum if the common directors of both companies were not counted.

The resolutions and protest of the Central Company adopted at the meeting of May 18, 1897, were communicated to the Harlem Company. At the meeting of the Board of Directors of the Harlem Company held on May 27, 1897 (Stip., p. 149, 151) Mr. William K. Vanderbilt was called to the chair. A resolution was adopted authorizing the execution of the mortgage securing the \$12,000,000 of the new bonds to the Guaranty Trust Company of New York. A resolution was also adopted authorizing the president and other officers to take any action necessary to carry into effect the resolutions of the Board of Directors on April 14, 1897, and of the stockholders' meeting of May 18, 1897. There were then presented the resolutions and protest adopted by the Board of Directors of the Central Company at the meeting of May 18, 1897; and then upon motion of Mr. Van Santvoord a resolution was unanimously adopted directing that the proceedings of the meeting be communicated to the New York Central Company and that such company be informed that it is the intention and purpose of the New York and Harlem Company to take the proceedings authorized by its directors and stockholders, and under the provisions of the lease to hold the New York Central and Hudson River Railroad Company responsible for the continuing payment of a sum equal to seven per cent. per annum on the \$12,000,000 Consolidated Mortgage Bonds; and that the company refused to comply with the request of the New York and Central Company served upon it on May 18, 1897; and further providing that the officers of the company be authorized and directed to retain counsel, and in conformity to the advice of counsel so retained, in every proper way to proceed, either by arbitration, sub-

mission or otherwise, to obtain and to expedite the prompt and proper construction and determination of all the rights of this company under the lease of April 1, 1873, and to assert and protect the rights of this company under that lease (Stip., 152). At this meeting there were eleven directors present, of whom the following, William K. Vanderbilt, Frederick W. Vanderbilt, Chauncey M. Depew, Charles C. Clarke and Samuel D. Babcock, five in all, were directors of the Central Company and E. V. E. Rossiter, secretary and treasurer of the Central Company. Of these directors William K. Vanderbilt, Frederick W. Vanderbilt and Chauncey M. Depew, Samuel D. Babcock and C. C. Clarke, voted as directors of the Central Company at the meeting held May 18, 1897, in direct contradiction of their vote at this meeting of the Harlem Company.

Again, excluding the common directors of both companies, there was no quorum at the meeting of May 27, 1897.

The Central Company on the 29th of June, 1897, commenced an action against the Harlem Company to restrain its proposed issue of bonds and seeking a construction of the lease of April 1, 1873, which would deprive the Harlem Company of any interest in the saving effected in the proposed refunding of the Consolidated Mortgage Bonds (Stip., 18, p. 14).

The Harlem Company answered the complaint, denying all the material allegations thereof, asserting its right to issue the new bonds and its right to a continued rental after the Consolidated Mortgage Bonds were retired and paid, of \$840,000 a year, the equivalent of seven per cent. interest on the retired bonds.

The attorneys appearing for the Harlem Company in the action were Messrs. Stetson, Tracy, Jennings & Russell, Mr. Stetson of that firm being the same Mr. Stetson who advised Mr. Twombly, as above stated.

The Central Company's suit was on the calendar for trial on the 16th of May, 1898, but was post-

poned until the October Term of 1898, because of the illness of one of the witnesses.

A meeting of the directors of the Central Company was held on June 22, 1898. At this meeting there were present seven directors, of whom the following—William K. Vanderbilt, Frederick W. Vanderbilt and Charles C. Clarke, were also directors of the Harlem Company. J. Pierpont Morgan was also present. Mr. W. K. Vanderbilt presented a preamble and resolution appointing the president and Messrs. Morgan and Twombly a committee to negotiate with the Harlem Company for an adjustment of the matters in controversy arising under the lease of April 1, 1873, and authorizing the president and secretary to execute, under the seal of the company, such agreements as may be necessary to carry the settlement into effect. The resolution was unanimously adopted. Of the seven directors present and voting, three were directors of the Harlem Company, as above stated.

On the 28th of June, 1898, a meeting of the directors of the Harlem Company was held, with Mr. W. K. Vanderbilt in the chair. There were eight directors present, and of these the following were directors of the Central Company—W. K. Vanderbilt, F. W. Vanderbilt and Samuel D. Babcock.

By a resolution unanimously adopted, a committee, consisting of Messrs. Van Santvoord, Freeman and Dutcher, was appointed to negotiate with the Central Company for an adjustment of the alleged matters in controversy under the lease of April 1, 1873. A resolution was also unanimously adopted that the report and agreement of the committee should be binding upon the company when and as approved by the stockholders thereof, and authority was given to the president, vice-president and secretary from time to time to execute, under the seal of the company, such agreements as may be necessary fully to carry into effect such settlement.

On August 10, 1898, the joint committee of the two companies, consisting of Messrs. Callaway, Morgan and Twombly for the Central Company, and Messrs. Van Santvoord, Freeman and Dutcher for the Harlem Company, met at the office of the New York Central Company. Mr. Callaway, president of the Central Company, was elected chairman.

Upon motion of Mr. J. P. Morgan, by the unanimous vote of all present, it was resolved that the differences should be settled by the execution, delivery and performance of the second supplementary contract, which forms the subject matter of this litigation (Stip., p. 224 *et seq.*).

On October 5, 1898, the supplemental contract and the report of the joint committee was submitted at a stockholders' meeting of the Harlem Company (Stip., p. 409). Protests were made by Mr. C. A. Collin, representing Mr. Hitchcock and others, and by Mr. Trull, against the approval of the second supplementary contract.

At the meeting 146,519 shares of the Harlem Company were represented and voted in favor of the second supplementary contract, and 11,042 shares voted against it (Stip., p. 412). The total representation of stock was 157,561.

On the 25th of November, 1898, a meeting of the Board of Directors of the Harlem Company was held, at which there were present eleven directors, of whom the following were also directors of the Central Company—C. Vanderbilt, W. K. Vanderbilt, C. M. Depew, C. C. Clarke, S. F. Barger, S. D. Babcock (Stip., p. 477, *et seq.*). Not counting the common directors, there was no quorum of the Harlem board. At this meeting of the board, the following proceedings were had: The president called attention to the action of the stockholders, approving the second supplementary contract, in adjustment of the differences between the Harlem and Central Companies and to the litigation pending between those companies. He also called attention

to the action of Mr. Hitchcock, a stockholder, to enjoin the execution of the second supplementary contract, and to the answer of the Harlem Company interposed by Messrs. Stetson, Jennings and Russell.

He further called attention to the advice of Mr. Stetson and Mr. Choate that the second supplementary contract should not be executed *until the decision of the Court in the Hitchcock suit*. The president in addition called attention of the board to the fact that it was desirable to avoid delay in the consummation of the sale of the Harlem bonds and that an agreement had been prepared by counsel between the Central Company and the Messrs. J. P. Morgan & Co., and Messrs. J. S. Morgan & Co., and the Harlem Company, permitting the issue of the bonds without prejudice. Upon motion by the unanimous vote of all the directors present, resolutions to the following effect were adopted:

It was resolved that until the *final determination* of the Hitchcock suit no action should be taken by the officers of the Harlem Company in execution or *completion* of the second supplementary contract.

It was further resolved that the president and secretary be authorized to execute, in the name of the company, a memorandum of agreement, dated 1st December, 1898, between the Central Company, the Harlem Company and the firms of J. P. Morgan & Co., and J. S. Morgan & Co.

This agreement provides, among other things, substantially as follows (Stip., p. 479):

FIRST.—Harlem Company to forthwith issue the new bonds as provided in the agreement between the bankers and the Central and Harlem Companies respectively.

New bonds to be used only in retirement of the Consolidated Mortgage Bonds of the Harlem Com-

pany for an equal principal sum, and in such manner and to such extent as from time to time shall accomplish the retirement of Consolidated Mortgage Bonds for an equal principal sum.

SECOND.—Bankers, under subsisting agreements between Central and Harlem Company, shall purchase and take the bonds mentioned in the preceding first section of this agreement, as issued and offered to them, such taking and purchase by the bankers to be in full performance of their subsisting agreements with the Central Company and the Harlem Company as far as those agreements relate to the Consolidated Mortgage Bonds.

THIRD.—Such issue, delivery and sale of the new bonds to be without prejudice to any existing right of either company; nor shall it be used or urged as any reason for any judgment in the suit of the Harlem against the Central Company unless that action be discontinued. The Hitchcock suit in which the Central and Harlem Companies are impleaded with Cornelius Vanderbilt and others shall *be heard and be decided* in the same manner and to the same effect as if the execution of the mortgage to the Guaranty Trust Company had been delayed to await such decision and as if this agreement had not been made.

A further resolution was adopted at this meeting directing the Secretary to transmit a copy of the proceedings and resolutions to the Central Company (Stip., p. 479).

The next step was had at a meeting of the Central directors. This meeting was held on the 28th day of November, 1898, three days after the Harlem meeting (Stip., p. 49). At this meeting there were nine directors present. Of these the following were also directors of the Harlem Company: Cornelius Vanderbilt, William K. Vanderbilt, Chauncey M. Depew, Samuel F. Barger, Samuel D. Babcock. Not counting the common directors, no quorum of the Central

Company was present. A resolution authorizing the execution of the contract relating to the issue of the Harlem bonds was adopted.

Having thus secured the issue of the new bonds in retirement of the consolidated mortgage bonds, the next step in execution of the plan was to obtain a discontinuance of the Central action against the Harlem and of the Hitchcock suit, to be followed by the execution of the second supplementary contract.

On April 4, 1900, the Hitchcock suit was discontinued. The discontinuance was negotiated by Mr. Stetson, attorney for the Harlem Company. "The said discontinuance was effected at the instance of the New York Central and Hudson River Railroad Company, and said Hitchcock, in consideration thereof, received 200 shares of the stock of the New York and Harlem Railroad Company furnished through or by J. P. Morgan & Co. (Stip. 28, p. 20). On the same day the suit of the Central Company against the Harlem Company was discontinued" (Stip. 2, p. 20).

On the same date the second supplementary contract was executed (Stip. 29, p. 21). Thus the resolution adopted by the Harlem directors that the second supplementary contract should not be executed until the Hitchcock suit was decided, was disregarded.

The Harlem directors refused to consent to the execution of the second supplementary contract unless indemnified by the Central Company against all damages. Accordingly, on the 4th of April, 1900, a meeting of the executive committee of the Central Company was held at which there were present six directors of whom the following were directors of the Harlem Company: C. M. Depew, Frederick W. Vanderbilt, Samuel F. Barger, Hamilton McK. Twombly (Stip., p. 492). Upon motion of the secretary a preamble and resolution was adopted in substance and effect as follows:

## PREAMBLE

Recites that arrangements have been made for the final discontinuance of the Hitchcock action.

That the Harlem Company is ready to execute and deliver the second supplementary contract if this company will indemnify and hold harmless its directors and the directors of the Harlem Company from all liability resulting therefrom (Stip., p. 492).

## RESOLUTION.

That the president and secretary of the Central Company are authorized, in the name and on behalf of that company, to execute and deliver to the President and Board of Directors of the Harlem Company a contract of indemnity against any and all loss, damage or liability resulting from any claim or suit on account of the execution of said contract and the performance thereof. Such contract to be in substantially the form now submitted to this meeting.

Following this resolution is a letter addressed to the President and Board of Directors of the New York and Harlem Railroad Company promising the indemnity as follows:

“That in case the said second supplementary contract shall be executed by and in behalf of your company, this company will indemnify and hold harmless each and every director of your company against any and all damage or liability (if any there shall be) because of or resulting from any claim or suit of any dissentient stockholder of your company, on account of the execution of said second supplementary contract and the performance thereof, and from time to time the Central Company will execute and deliver to you further assurance in the premises as from time to time may become necessary” (Stip., p. 493).

This letter was signed S. R. Callaway, president; and Edward Worcester, as secretary of the Central

Company, sealed with the seal of the company and delivered to the Harlem Company on April 4, 1900.

The resolution authorizing the contract of indemnity was adopted on motion of Mr. Twombly. Thus, C. M. Depew, F. W. Vanderbilt, S. F. Barger and H. McK. Twombly, as directors of the Central Company, voted that the Central Company should indemnify themselves and others as directors of the Harlem Company against all damages for authorizing the execution of the second supplementary contract. On the same day, April 4, 1900, a meeting of the executive committee of the Harlem Company was held, at which there were present five directors; of whom C. M. Depew, F. W. Vanderbilt, H. McK. Twombly and S. F. Barger were directors of the Central Company and had just acted as the Executive Committee of the Central Company. Mr. Depew was called to the chair; he laid before the committee a communication from the Central Company advising that that company had arranged for the discontinuance of the Hitchcock action and the pending litigation between the Central and Harlem Companies, and for indemnifying the directors of this company. The chair stated that Mr. Stetson, who was present, as counsel for this company, advised that the discontinuance of the Hitchcock action would constitute a final determination within the meaning of the resolution of the Board of Directors of the Harlem Company adopted November 25, 1898. Thereupon, by a unanimous vote, the secretary of the company was authorized and directed to execute and deliver, under the seal of the company, the second supplementary contract, and that upon such execution the contract should be in full force, although the signature of the vice-president of the company might be affixed after such delivery (Stip., p. 495-496).

The foregoing review of the steps and proceedings which culminated in the second supplementary contract must convince the Referee that the dispute was not real but feigned, and that there never was an

intention upon the part of the dominant and controlling directors of the Central and Harlem companies to obtain a judicial construction of the rights of either the Central or the Harlem Company under the lease of 1873. The outlined plan, the activities of the common directors towards a dispute and compromise, the contradictory votes of the common directors, one day voting as Harlem directors that the Harlem had the right to pay off the bonds and issue the new mortgage, the next day as Central directors, voting that the Harlem Company was without any such right; this repeated day after day, until the self-stultification was too glaring for real transactions—all indicate that a real determination of the rights of the parties under the lease of 1873 was not the object sought, but that the real object sought was, as the outlined plan indicated, an apparent compromise which should result in depriving the Harlem Company of its legal rights and give to the Central Company a share of the saving in interest, and the greater share of such saving. This was the result accomplished, and this was the result to which every act and proceeding from April, 1897, to April 4, 1900, on the part of the common directors, pointed. Consider how easy it was to have obtained a judicial construction of the lease with speed and promptness had such construction been at all desired! All that it was necessary to do was to make an agreed case and submit the question as to the rights of the parties under the lease of 1873 to the Appellate Division of the Supreme Court. A demurrer to the complaint of the Central Company would also have involved and secured a construction of the rights of the parties under the lease. Neither of these obvious courses was pursued, but the action was suffered to drag along until it was ripe enough to furnish a color of consideration by its discontinuance for the compromise which had been planned and intended from the first.

(b.) It is clear too, that the suit of the Central Company against the Harlem Company was but a piece of machinery for securing a reduction in the rental of the Central Company.

The complaint in the Central action claims that the Harlem Company is under obligation immediately to issue to it \$12,000,000 of bonds with which to retire the CONSOLIDATED MORTGAGE BONDS (Paragraph XXIV., p. 25).

There is not a suggestion in the complaint that the Central Company had paid the CONSOLIDATED MORTGAGE BONDS, which payment by Article 6 of the Lease is a condition precedent to its right to demand the issue of new bonds by the Harlem Company; but the bald claim is made that without such payment by the Central Company it had the right to demand from the Harlem Company the issue to the Central Company of \$12,000,000 of new bonds.

The complaint then alleges (Paragraph XXX., p. 27), that the issue of the new bonds by the Harlem Company will work great and irreparable loss and injury to the plaintiff, its property and business, and the value of the stock of its stockholders. Judgment is then prayed that the Harlem Company be adjudged to issue the mortgage for \$12,000,000; that it be adjudged that the plaintiff has the right to pay and discharge the \$12,000,000 CONSOLIDATED MORTGAGE BONDS; and that the defendant company, its directors and officers be enjoined and restrained from issuing a mortgage to the Guaranty Trust Company, and that the seven persons who then constituted the majority of the directors of the plaintiff and defendant's company, be restrained and perpetually enjoined from doing any act or thing in furtherance or aid of the claims of the Harlem Company.

The provisions of the Sixth Article of the Lease make payment by the Central Company of the CONSOLIDATED MORTGAGE BONDS a condition precedent to its right to demand from the Harlem Company the issue of any bonds.

The Referee's decision adjudging that the Harlem Company had the right to issue the new bonds and pay off the CONSOLIDATED MORTGAGE BONDS answers in every particular the claim of the complaint in the Central suit that the Harlem Company was without such right. The allegation in the Central complaint against the Harlem Company that the issue of the new bonds would occasion irreparable injury to the Central Company has neither foundation in fact or law, even assuming that any covenant in the lease of April, 1873, prevented such issue.

How could the Harlem Company possibly be injured by a violation of that covenant, assuming, which is not the fact or law, that it prevented such issue? Any new mortgage or new bonds would be subordinate to the lease to the Central Company, even in the absence of an express provision to that effect. This was expressly decided upon the motion to dismiss the complaint. In the opinion delivered upon that motion the Referee said:

"But a mortgage created by the Harlem Company on its reversionary interest was not prohibited by the sixth article, and such a mortgage without express provision to that effect, would be subject and subordinate to the lease." But the mortgage, the issue of which was sought to be restrained in the action of the Central Company, was expressly made subject to the lease, since it contains a provision to that effect (Stip., p. 168), which is as follows: "Subject, however," \* \* \* "to the rights of the New York Central and Hudson River Rail Road Company in respect to any of said property" \* \* \* "under the lease above mentioned, bearing date April 1, 1873."

It is too plain for argument, that as the proposed mortgage did not affect the leasehold rights of the Central Company, and that as the issue of the new bonds could not in any degree increase its obligations to the Harlem Company, neither irreparable

or other injury would be occasioned to the Central Company by their issue,

Assuming that Article V. of the lease prohibited the issue of the new bonds, all that would have happened by their issue was a technical breach of a covenant, the breach of which did not disturb or affect the rights of the Central Company as lessor and could not possibly occasion it any damage.

The complaint of the Central Company in its suit against the Harlem Company was, therefore, not only untrue in its material allegation, but utterly failed to state any fact constituting a cause of action in equity. An allegation of irreparable injury unaccompanied by a statement of facts showing that the injury will be irreparable is always treated and regarded as insufficient, and where, the injury is pecuniary damage, a court of equity never interferes unless there be an allegation that the party occasioning the damage is irresponsible.

It is confidently submitted that the Central-Harlem litigation was in its entire scope and breadth neither more nor less than a detail of the plan to secure to the Central Company a reduction of rental.

### III.

**Boards of directors constituted as were those of the Central and Harlem companies could not legally compromise a dispute between their respective companies under the circumstances disclosed by the evidence.**

(a.) It is manifest from a review of the evidence that the directors of the Central Company, who were at the same time directors, officers, members of the Executive Committee and proxies for stockholders in the Harlem Company, dominated and

controlled the latter company. The Boards of Directors of the two companies being thus constituted and many of the members being interested as stockholders in both companies, they were incapable of creating and compromising a dispute as respects the rights of the respective companies under the lease.

The general rule as to the power of corporations to settle and adjust controversies arising between them, is not disputed. That rule applies undoubtedly with full force to corporations having independent Boards of Directors dealing with each other at arms' length. It is submitted it can have no application to a case like the present, where the question is simply one as to the correct construction of a written instrument and the rights of the parties thereunder, and where the disputing parties are managed, governed and controlled by the same directors who, in the creation of the dispute and its compromise, have diverse and conflicting duties and obligations, and who, in their character of trustees, in the creation and compromise of the dispute, represent distinct, independent and adverse beneficiaries, and hostile and conflicting interests.

It is the settled law of this State that in equity directors of corporations are trustees and are charged with the duties, responsibilities and subject to the disabilities of trustees, the same as ordinary trustees (*Bosworth vs. Allen*, 168 N. Y., 157, 164-166). When a trustee finds himself standing in a relation either to trust property or with respect to the performance of some duty relating to his trust, as that he is called upon to decide concerning the rights and interests of adverse and hostile beneficiaries whom he represents, there is but one proper course for him to pursue, whether he be an executor, administrator or an ordinary trustee, and that is, to submit the question of the rights of the beneficiaries whom he represents to the decision of the Court, or to the beneficiaries themselves upon a full disclosure. He is not permitted to create a dispute with

himself and then compromise it with himself, or to create a dispute between his beneficiaries and then compromise it, as was done in the case at bar. Nor is there anything in the statement in the Referee's opinion in this case, "that the trend of recent judicial authority tends to support the rule that corporations may make fair and reasonable contracts with each other, although they have common directors, and that such contracts are neither void nor voidable *per se*," at variance with the contention made that it was not competent under the circumstances of this case for the directors of the Central Company, who were directors of the Harlem Company, to create a dispute between themselves and then compromise it. None of the considerations stated as leading to the conclusion expressed has any application to the circumstances of the dispute and compromise in question. The reason given for the rule expressed is "the great expansion in recent times of business corporations, the intimate relations which often exist between them, the participation in many cases of the same persons in the management of corporations, between which occasions may arise for mutual business arrangement, and the necessity of establishing a *workable rule* which, while protecting the interests of each corporation and its stockholders, shall not render such arrangements impracticable, has led to a modification of a stricter rule which in some of the earlier cases has been declared, by which contracts between corporations having common directors are voidable at the election of either."

None of these reasons apply to the case at bar. No occasion for mutual business arrangements between the Central and the Harlem Companies could possibly arise. The Harlem Company, at the date of the alleged dispute and its compromise, was engaged in no business except the collection of its rentals from the Central and the Metropolitan Companies, and the distribution of those rentals by way

of dividend to its stockholders. There was no occasion for any workable rule to conserve business arrangements between the two companies, and hence it is insisted that the case presented by the evidence, of a dispute created and compromised with respect to legal rights of beneficiaries having common trustees, but adverse and conflicting interests, is not a case which comes within the rule that common directors may make fair and reasonable contracts between and on behalf of corporations they represent.

There is abundant authority in support of the proposition that where common directors constitute a majority in each board, their action as respects transactions between the two companies thus represented is invalid, under the circumstances disclosed by the evidence.

*Taylor on Private Corporations* (5th Ed.), p. 646.

1 *Morawetz on Corp.*, Secs. 529, 530.

*Pearson v. Concord R. R. Corp.*, 62 N. H., 537.

*Met. El. R. Co. v. Man. El. R. Co.*, 11 Daly, 377, 485.

*Met., &c., Co. v. Dom., &c., Co.*, 44 N. J. Eq., 568.

*Fitzgerald v. F. & M. Cons. Co.*, 44 Neb., 463.

*Stokes v. Phelps Mission*, 47 Hun, 570.

*Goodin v. Cin. & Whitewater Canal Co.*, 18 Ohio St., 169, 182-183.

*Parsons v. Tacoma Smelt. & Refining Co.*, 25 Wash., 492.

*Goodell v. Verdugo Canon Water Co.*, 138 Calif., 308; s. c. 71 Pac. Rep., 354 (Jan., 1903).

In *Taylor on Private Corporations* (5th Ed.) Sec. 644 (p. 646), the author says:

“And it has been finally held, and with  
“such propriety of reasoning as to lead one

“to believe that the rule will remain fixed  
 “that when common directors constitute a  
 “majority in each board, the two boards of  
 “directors cannot in the same transactions  
 “validly represent two adversely interested  
 “corporations.”

In *Pearson v. Concord R. R. Corp.*, 62 N. H., 537, contracts between railroads having a majority of common directors, and compromises of claims effected through such common directors, were set aside regardless of their fairness.

The Court said (p. 545):

“It was for the interest of the upper companies to procure the lowest rates, and their directors were bound to use the knowledge they had derived from the confidence reposed in them as directors to attain that result; and the interest of the Concord was to procure the highest rates, and its directors were bound to use their special knowledge for the advantage of that company. Their interests being conflicting, it was impossible for common directors to procure the lowest rates for one party and the highest rates for the other. ‘No man can serve two masters.’ They were not arbitrators, called in to adjust conflicting claims, nor were they disinterested. \* \* \* By taking the control of the Concord, the upper companies disabled it as a contracting party. In fixing the rates of that company for their business, they were contracting with themselves. When a transaction is a fraud in law, it is unnecessary to prove a fraud in fact nor is it permissible to show that the transaction was an honest one. *Coburn v. Pickering*, 3 N. H., 415. The justness of the contracts made with themselves and of the votes they passed as directors of the Concord Railroad for their own benefit does not impart any validity or legality to those contracts or votes. If such contracts were to stand until shown to be fraudulent and corrupt, the result, as a general rule, would be that

“they must be enforced in spite of fraud or corruption (*Railway Co. vs. Dewey*, 14 Mich., 477).”

And at page 546 the Court said further:

“The question whether the contracts made by the defendants for rates over the lower roads are fair and just, and whether the upper companies have valid and legal claims against the Concord, cannot be litigated or contested with the upper companies by a board of Concord Railroad directors whose interests are opposed to those of the Concord, and are in harmony with those of the upper companies.

“In the making of these contracts and in the settlement of these claims, the stockholders of the Concord have the legal right to the services of directors whose interests are not hostile to their interests. A director or stockholder in the Northern or B. C. & M. Company is not such a director. It may, for most purposes, be convenient and desirable that the same person or persons should act as directors of two or more roads forming parts of a continuous line. For many purposes their interests are not adverse. The harmonious working of the several parts, when a large portion of its business is the transportation of goods and passengers over the whole line, requires unity of purpose and management. *Burke v. Concord R. R.*, 61 N. H., 160, 233, 234. But however all this may be, the right of the stockholders of a single road, that it shall be operated primarily in their own interest, cannot be overridden or displaced by directors occupying inconsistent relations.”

The Court states its conclusion on this part of the case at page 548, as follows:

“Our conclusion upon this part of the case is, that the directors of the Concord could not make the contracts with the upper companies, nor settle the claims of those

“companies against the Concord. For the  
 “transaction of that part of the business of  
 “their office they were disabled by the under-  
 “standing on which, the purpose for which,  
 “and the interest in and by which, they were  
 “elected.”

In *Fitzgerald v. Fitzgerald & Mallory Cons. Co., Mo. Pac. R. R. Co. et al.*, 44 Neb. 463, the actions of the common majority directors of a construction company and a railroad company were under review at the suit of a dissenting minority stockholder. In considering this matter the Supreme Court of Nebraska said (pp. 490-491):

“Another intrinsic vice of the transaction  
 “is that a majority of the directors of the  
 “construction company were, by reason of  
 “adverse interest, disqualified to act therein.  
 “The action of February 7, 1887, differs from  
 “that resulting in the disposition of the  
 “bonds, since the Missouri Pacific Company  
 “was one of the contracting parties, and rep-  
 “resented at said meeting by Mr. Gould,  
 “whose dominion over both corporations, it  
 “appears, was absolute. The directors of the  
 “construction company present thereat were  
 “Messrs. Mallory, who acted as president,  
 “Cross, George Gould and Sage, the two  
 “latter being also directors of the Missouri  
 “Pacific Company. One who is agent for  
 “two parties cannot, in the absence of ex-  
 “press authority from each, represent both  
 “in a transaction in which their interests  
 “conflict. (Morawetz, Corporations, 528;  
 “Mechem, Agency, 455.) And never was the  
 “infallible truth that a man cannot serve two  
 “masters better illustrated than by the  
 “facts of this case. Each party to the  
 “agreement was interested in secur-  
 “ing the most advantageous terms  
 “consistent with fair dealing and  
 “the rights of the other, hence Messrs. Gould  
 “and Sage could not at the same time protect  
 “the rights of both corporations. Conceding  
 “the personal integrity of the directors  
 “named, as well as of Mr. Cross, who acted

“ with them, still the law has placed the seal  
 “ of its disapproval upon the transaction and  
 “ pronounced it fraudulent, not on account  
 “ of any imputed evil purpose on their part,  
 “ but from motives of public policy. It was  
 “ said in *Gorder v. Plattsmouth Canning Co.*,  
 “ 36 Neb., 548: ‘The relation of directors to  
 “ the stockholders of a corporation is not  
 “ essentially different from that ordinarily  
 “ existing between trustees and *cestui que*  
 “ *trust*. Courts of equity will set aside such  
 “ contracts for fraud, and generally on a  
 “ slight showing of fraud on the part  
 “ of the trustee,’ and the proposition that  
 “ this transaction is fraudulent as against  
 “ the construction company, without regard  
 “ to the motives of the directors named, is  
 “ sustained by the following among the many  
 “ cases which might be cited to the same  
 “ effect: *United States Rolling Stock Co. v.*  
 “ *Atlantic & G. W. R. Co.*, 34 O. S., 450;  
 “ *Kitchen v. St. Louis, K. C. & N. R. Co.*, 69  
 “ Mo., 204; *Flagg v. Manhattan R. Co.*, 4  
 “ Am. & Eng. R. R. Cases, N. Y., 141; *Beach*,  
 “ *Private Corporations*, 247.”

*Stokes v. Phelps Mission*, 47 Hun, 570 (Genl. T.,  
 1st Dept., 1888), was another case where two cor-  
 porations having common directors were held inca-  
 pacitated to contract with each other.

The Court (Van Brunt, *P. J.*) says, at page 573:

“ The principle that corporations have com-  
 “ mon officers and trustees cannot enter into  
 “ valid contracts with each other has become  
 “ well established in the jurisprudence of this  
 “ country and in England (*Metropolitan Ele-*  
 “ *vated Railway Co. v. The Manhattan*  
 “ *Railway Co.* 11 Daly, 373, and cases  
 “ there cited), and needs no elaboration here.  
 “ It is held that each corporation has the  
 “ right to the unbiased counsel of each of its  
 “ officers and trustees; and where an officer  
 “ or trustee is connected with two different  
 “ corporations each, in any dealings between  
 “ the two, will be deprived of that to which  
 “ they are entitled, viz., the unbiased aid and  
 “ counsel of such trustee; and, therefore, they

“ must not contract, and if they do so, such  
 “ contract will be set aside at the instance of  
 “ any party having the right to call the  
 “ transaction in question.”

In *Parsons v. Tacoma Smelting & Refin. Co.*, 25 Wash., 492, a lease from one corporation to another was set aside, where a common director's vote was necessary to pass the resolution for the lease at the board.

The Court said (pp. 496-497):

“ 1. At the trustees' meeting there were  
 “ present four of the board of seven—Anderson, Oakes, Browne and Rust—of whom  
 “ Rust was a promoter and trustee of the new  
 “ corporation, and controlling a majority of  
 “ the stock in the old company. Section 4257  
 “ Bal. Code, declares:

“ ‘ A majority of the whole number of  
 “ ‘ trustees shall form a board for the  
 “ ‘ transaction of business, and every de-  
 “ ‘ cision of the majority of the persons  
 “ ‘ duly assembled as a board shall be  
 “ ‘ valid as a corporate act.’ ”

“ It is maintained by counsel for respondents that the statute makes every act of a  
 “ majority of a quorum, when assembled,  
 “ valid, and that the statute is merely confirmatory of the existing rule at common  
 “ law. This view of the validity of such  
 “ action seems to omit a consideration of the  
 “ trust held by the director. Each occupies  
 “ a fiduciary relation to the corporation and  
 “ to each stockholder. He must faithfully  
 “ perform his trust. The ordinary obligation  
 “ attending trust relations attaches to the  
 “ trustee of a corporation. The policy of the  
 “ law forbids a trustee to assume a double  
 “ function where there are adverse interests  
 “ considered.”

In *Higgins vs. Lansingh*, p. 154 Ill., 301, a settlement between a corporation and its creditors, which was adopted at a meeting of the board of managers, where three of the six managers present were either

creditors or connected with creditors, was held to be invalid on account of such adverse interest, regardless of the fairness.

The Court said (p. 363):

“ However that may be, we think it clear  
 “ that the three managers, J. Woodbridge  
 “ Smith, Turner and Blodgett, were by rea-  
 “ son of their being interested adversely to  
 “ the company, incapable in law of acting  
 “ and voting, as managers of the company,  
 “ in making this settlement. They were  
 “ acting as the agents of the corporation in  
 “ making a contract with themselves and  
 “ others interested as creditors, or with the  
 “ creditors, of the company, when their in-  
 “ terests were in conflict with the interest of  
 “ the company, and while the peculiar cir-  
 “ cumstances attending this transaction may  
 “ have been such that they could fairly do  
 “ what appeared to be for the best interests  
 “ of both the corporation and the creditors,  
 “ still the law will not permit the agent to so  
 “ deal with himself in transacting the busi-  
 “ ness of his principal as to bind the latter so  
 “ that he cannot avoid the transaction 1)  
 “ Morawetz on Private Corp., Secs. 517,  
 “ 525). It will be noticed that without the  
 “ vote of one or more of the three man-  
 “ agers in question the resolution could  
 “ not have been adopted. Under the by-  
 “ laws it took four managers to constitute a  
 “ quorum for the transaction of business of  
 “ such a character—the same number re-  
 “ quired in the absence of any by-law on the  
 “ subject, the board consisting of seven mem-  
 “ bers. Whether the three members who  
 “ were disqualified should be treated as pres-  
 “ ent or absent is immaterial, for if treated as  
 “ present, and with the others forming a  
 “ quorum, three was not a majority of this  
 “ quorum voting for the resolution when  
 “ their votes are excluded; and if treated  
 “ as absent, then no quorum of the board  
 “ was present.”

In *Thomas v. The Brownville, Ft. K. and Pac. Ry. Co.*, 2 Fed. Rep., 877, where it appeared

that two members of the directorate of a railway company, after the execution of a contract for construction, associated themselves with the persons who had taken that contract, the Court held that the contract was voidable at the option of the stockholders.

The Court stated its conclusion on this point as follows (p. 878):

“ 1. That the admission into the construction company, under the construction contract, of two officers of the railroad company, was unlawful and vitiated the contract. It matters not whether the contract was entered into with the understanding that the two railroad directors were to be admitted or not, their presence as parties on both sides during the progress of the work, and when payments and settlements were to be made under the contract, is enough. *Wardell v. R. Co.*, 4 Dillon, 33; *R. Co. vs. Poor*, 59 Me., 270.”

The Court then considered an alleged ratification by the board of directors of the railway company, and said (p. 879):

“ A ratification, to have this effect, must be made by a board composed of disinterested directors. It is not enough that such a contract has been ratified by a board composed in part of the interested directors. The least that can be required in such a case is that the directors concerned in the contract shall resign, and allow their places to be filled by persons who can, without bias, represent the interests of the corporation, and particularly of the individual stockholder.”

In this case it also appeared (p. 880) that the parties with whom the construction contract was made agreed to relieve certain stockholders of the railway company (including all the directors) from any further liability for assessments on their stock.

This, the Court held, also made all the directors adversely interested.

It was held in *Anderson v. Aronson*, 3 How. Pr., N. S., 216, that the presence of an interested director at a meeting where the resolution is passed, invalidated the resolution.

The Court said (p. 229):

“ I am of the opinion that the presence of  
 “ Rudolph Aronson at those meetings viti-  
 “ ated the action of the directors in respect to  
 “ all matters which related to his individual  
 “ interests. If authority is necessary for this  
 “ conclusion, the able opinion of Justice Van  
 “ Brunt in the case of the Metropolitan Ele-  
 “ vated Railway Company agst. Manhattan  
 “ Railway Company (14 Abbott New Cases,  
 “ 103, 293, 294), may be cited. In that case,  
 “ the learned Justice, after an elaborate re-  
 “ view of numerous cases, at page 293, says:  
 “ ‘The rule, therefore, seems to be clearly  
 “ established that the question of minority  
 “ cannot be considered in determining the  
 “ right in equity to avoid a contract. The  
 “ presence of one disqualified director is just  
 “ as fatal to action which cannot be repudi-  
 “ ated as the existence of a dozen. It being  
 “ impossible to ascertain the amount of in-  
 “ fluence which each director exerts, or which  
 “ he fails to exert in opposition to action in  
 “ which he is interested, the only rule which  
 “ can be adopted, or which can be applied  
 “ with any certainty, is that if there is even  
 “ one director who is disqualified, the whole  
 “ action of the board is subject to repudia-  
 “ tion (see also *Butts agst. Wood*, 37 N. Y.,  
 317).”

#### IV.

**The second supplementary contract is so unjust and unfair in its provisions and so manifestly in the interest of the Central Company and against**

**the interest of the Harlem Company, that, having been authorized by directors of the Central Company, who were at the same time directors of the Harlem Company, it is voidable at the suit of the plaintiffs.**

(a.) In the opinion delivered by the Referee upon the motion to dismiss the complaint, speaking of the reasonableness and fairness of the second supplementary contract, he stated:

“It is manifest, if I have properly construed the lease, that the compromise agreement was against the interests of the Harlem Company and its stockholders and in the interest of the Central Company, its stockholders and bondholders. What the Harlem Company lost and what the Central Company gained thereby, measured by the life of the lease, amounted to a vast aggregate. The transaction challenges the closest scrutiny into the circumstances which led to and terminated in an agreement so injurious to the Harlem Company.”

Again, speaking of contracts between corporations having common directors, it was observed:

“But they awaken the attention of a court of equity, and if there is actual fraud, or if they were made to accomplish some private or selfish purpose to the injury of stockholders destructive of their rights, or are *oppressive or unfair*, or if by contrivance or collusion or undue influence the interest of the stockholders has been sacrificed, and their legal or *just rights disregarded* or overborne; in these and like cases the courts will interfere at the instance of the corporation injured and prevent their execution, or if executed will rescind and set them aside.”

The rule as stated by the Referee, is approved and applied by the following authorities and whenever

the contract or transaction was found to be unjust or unfair it was set aside.

2 Cook. on Corp., Sec. 658 and cases cited.

3 Thompson on Corp., Sec. 4079.

*Munson v. S. G. & C. R. R. Co.*, 103 N. Y., 58, 73-74.

*Met. Eled. Co. v. Man. El. Co.*, 11 Daly, 373, 503, 515.

*Burden v. Burden*, 159 N. Y., 287, 307.

*N. Y. Cent. Ins. Co. v. Nat. Pro. Ins. Co.*, 14 N. Y., 85.

*Barr v. N. Y., L. E. & W. R. R. Co.* 52 Hun, 555.

*U. S. Ice Co. v. Reed*, 2 How. Pr., N. S., 253.

*Anderton v. Aronson*, 3 How. Pr., N. S., 216, 229.

*Wardell v. U. P. R. R. Co.*, 103 U. S., 651.

*Twin Lick Co. v. Marbury*, 91 U. S., 587.

*Coe v. E. & W. R. R. Co.*, 52 Fed. Rep., 531.

*San Diego, O. T. & P. B. R. R. Co. v. Pacific Beach Co.*, 33 L. R. A., 788 (112 Calif., 53).

*The Evarsville Pub. Hall Co. v. The Bk. of Commerce*, 144 Ind., 34.

*Smith v. Wells Mfg. Co.*, 148 Ind., 333, 345.

*Library Hall Co. v. Pittsburgh Assn.*, 173 Pa. St., 30, 41.

*Grant v. United, &c., Ry.*, L. R., 40, Ch. D., 135.

*Leathers v. Janney*, 41 La. Ann., 1120.

*Bill v. W. U. Tel. Co.*, 16 Fed. Rep., 14.

*O'Connor Min., &c., Co. v. Coosa Furnace Co.*, 95 Ala., 614, 617.

*Memphis, &c., R. R. Co. v. Woods*, 88 Ala., 630.

The injustice, unfairness and oppressive character of the second supplementary contract in question is too apparent to require argument.

Counsel for the defendants, as we have already seen, admits that the value of the demised property has increased, and yet by the terms of the second supplementary contract the rental is reduced \$220,000 per annum.

In the division of the saving of interest the greater share is given to the Central Company, namely, \$220,000, being \$20,000 in excess of the amount allotted to the Harlem Company, amounting, for the unexpired term of the lease to upwards of \$7,400,000. The excess of \$20,000 a year given to the Central Company was so given upon the childish plea, as stated in the circular to the stockholders of the Harlem Company, that the amount allowed the Harlem Company was the nearest possible approach to exactly one half, if an even percentage be adopted. It is clear that \$220,000 a year would be just as near an even percentage on the \$10,000,000 capital of the Harlem Company as it would be upon the \$115,000,000 capital of the Central Company. This bonus of upwards of \$7,000,000 to the Central Company is convincing evidence of the unfairness of the contract, and that the interest of the Central Company was the chief care and the sole solicitude of the controlling Central directors.

Other particulars in which the second supplementary contract sacrificed and disregarded the interests of the Harlem Company and its stockholders were enumerated by Mr. Milburn in his oral argument, a printed copy of which is herewith submitted.

The second supplementary contract bears upon its face, when read in the light of the circumstances surrounding its execution, convincing evidence of the deliberate intention of its promoters to protect and secure the interests of the Central Company, at the expense of the rights and interests of

the Harlem Company and the great body of its stockholders.

## V.

**The vote of the stockholders of the Harlem Company in approval of the second supplementary contract is not binding upon the plaintiffs nor effectual to estop them from questioning the validity of that contract.**

(a.) The circular issued to the stockholders was misleading and did not fully apprise them of their rights and interests under the lease of 1873, which the second supplementary contract surrendered and sacrificed.

The stockholders were advised by the circular that as a result of the pending litigation between the Central and Harlem Companies "one or the other must gain either the whole or none of the benefit to be effected by the proposed saving in annual interest." The stockholders of the Harlem Company were thus given to understand that judgment in the pending litigation between the two companies in favor of the Central Company would be decisive against the right of the Harlem Company to share in any portion of the saving in interest effected by refunding the consolidated mortgage bonds. The stockholders were not informed that under the terms of the lease of 1873, the Harlem Company had the right to use its credit and borrow money and pay off the consolidated mortgage bonds, as is the fact beyond dispute. Indeed, the entire burden of the argument of the counsel for defendants upon the

motion to dismiss the complaint was, that the sole right given to the Harlem Company was to pay the consolidated mortgage bonds in cash obtained in some other way than by mortgaging the demised property. Nor did the circular advise the Harlem Company, as is the fact, that there was in the Harlem treasury \$3,000,000 of available assets which could be used in the payment of the consolidated mortgage bonds to that extent, and which, if so used, would give to the Harlem Company an annual revenue of \$210,000 after May 1, 1900, being \$10,000 per year in excess of the amount which the company would receive under the second supplementary contract, which the circular advised the Harlem Company to approve. Nor did the circular advise the stockholders of the Harlem Company that the credit and resources of that company were amply sufficient, as is the fact established by the evidence, to borrow the money to pay off the consolidated mortgage bonds upon collateral trust notes secured by a collateral trust mortgage upon the lease of the Harlem Company to the Central Company, and the lease of the Harlem Company of its street railway property to the Metropolitan Street Railway Company. On the contrary, the circular carefully suppresses and conceals from the stockholders the rights of the Harlem Company under the lease of 1873, and gives them to understand that, unless they give their approval to the second supplementary contract, they may lose, through an adverse decision in the pending litigation, any share in the saving of interest resulting from the payment of the consolidated mortgage bonds.

A circular, fully and fairly disclosing to the Harlem stock-holders their rights, and the facts and circumstances relating to the second supplementary contract, would have adverted to the following considerations:

Through a majority of the directors of the Central Company being also a majority of the directors

of the Harlem Company the determination of the matter is necessarily with the stockholders.

Since April, 1897, the Central Company has been endeavoring to reduce the rental payable to the Harlem Company under the lease of 1873, in the amount of half the saving of interest which may result from the payment of the Consolidated Mortgage Bonds.

The Harlem Company has authorized the issue of a new mortgage for \$12,000,000 and the issue of  $3\frac{1}{2}$  per cent. 100-year Gold Bonds, and can market the issue.

There is pending a suit between the Central Company and the Harlem Company denying the right of the Harlem Company to obtain the money to pay off the Consolidated Mortgage Bonds by the issue of these new bonds.

It is of the first importance to the Harlem Company and its stockholders that this suit be promptly tried and an adjudication as to the right of the Harlem Company to issue the new bonds be obtained, as, in case the decision should be adverse to the Harlem Company, it will still have the right to pay off the Consolidated Mortgage Bonds by the use of available assets amounting to \$3,000,000, and by a collateral trust mortgage securing collateral trust notes or debenture certificates by the pledge of the lease of the Harlem Company to the Central Company, and the lease of the Harlem Company to the Metropolitan Street Railway Company, which, after May 1st, 1900, will return a net revenue to the Harlem Company of \$1,990,000, and after July 1st, 1901, will return a net revenue to the Harlem Company of \$2,040,000. The security for this proposed issue of collateral trust notes or debenture certificates can be made by appropriate provisions in the collateral trust mortgage, far superior to that of the mortgage securing the proposed new issue of bonds, which the suit of the Central Company against the Harlem Company seeks to enjoin, as that mortgage only

covers the railroad property of the Harlem Company north of 42nd Street and does not include its street railway properties.

The provisions in the collateral trust mortgage to give it such superiority as a security, could be as follows:

The Harlem Company agrees never to mortgage or place or create any lien upon the property now leased by it to the New York Central and Hudson River Railroad Company or to the Metropolitan Street Railway Company, until the collateral trust notes or debenture certificates secured by this mortgage and issued thereunder shall have been fully paid and discharged, principal and interest; and the Harlem Company further agrees that in the event of the termination for any cause during the life of this indenture of the lease of April, 1873, of the railroad properties of this company to the Central Company, then and in that event, this mortgage shall extend to and include and be a lien upon all the property, franchises, rights and privileges covered by or included in either the lease of April, 1873, to the Central Company, or the lease of July 1, 1896, to the Metropolitan Street Railway Company, as and for further security for the payment of each and every collateral trust note or debenture certificate secured hereby or issued hereunder.

As the property leased to the Metropolitan Street Railway Company is not included in the mortgage to which the Central Company objects, and as that property brings in a net annual rental of \$400,000, which, capitalized at four per cent., gives a value of \$10,000,000, it is plain that the security furnished by the collateral trust mortgage will be superior to that furnished by the proposed mortgage which has been authorized, and the issue of which the Central Company seeks to enjoin in the pending action.

The collateral trust notes or debenture certificates

can be for the same term as the proposed new bonds, namely, 100 years, and bear interest at the rate of  $3\frac{1}{2}$  per cent.

These debenture certificates can be offered to the stockholders of the Harlem Company with the privilege of subscribing for them in the proportion of the number of shares of stock held by each stockholder to the entire issue, and this right of subscription can be made assignable, thus securing to the stockholders of the Harlem Company any premium upon the issue less commission. The Harlem Company will under this plan receive the sum of \$420,000 a year instead of \$200,000 a year, as contemplated by the Second Supplementary Contract herewith submitted.

It is only necessary to compare a circular so framed with the circular actually issued to the Harlem Company stockholders to grasp and understand the extent of the injury done to the Harlem stockholders through the instrumentality of the circular actually issued to them.

The circular having omitted to apprise the stockholders of the Harlem Company of the rights of that company under the lease of 1873, and the facts and circumstances relating to the contract whose approval it sought, rendered the vote ineffectual for any purpose as against a minority stockholder, or even as against a stockholder participating in the vote.

Cumberland Coal Co. *vs.* Sherman, 30 Barb., 553.

Gilman, C. & S. R. R. Co. *vs.* Kelly, 77 Ill., 426.

In Cumberland Coal Co. *v.* Sherman (*supra*), where the Court had under consideration acts of a director adversely interested to his corporation, and reiterated the familiar rule as to the trust relation

and consequent disability under such circumstances, it was held that a ratification by the stockholders of such improper acts could only be valid after a full disclosure by the director of all the circumstances, and that the burden was on the director to show that such a full disclosure had been made and that the transaction was fair.

The Court says (p. 574):

“The trustee must show that he took no  
“advantage whatever of his situation; that  
“he gave to his *cestui que trust* all the infor-  
“mation which he possessed or could obtain  
“upon the subject; that he advised him as he  
“would have done in relation to a third per-  
“son offering to become a purchaser, and that  
“*the price was fair and adequate*, and the  
“onus of proving all this is upon the trustee;  
“and these principles apply to all cases where  
“confidence is reposed.”

The Court then considers the facts of the case in order to determine whether a full disclosure had been made, and in its discussion of that question says (speaking of the director) at page 576:

“If he had knowledge of them, it was  
“clearly his duty, when he sought the stock-  
“holders to obtain from them a confirmation  
“of this sale, to have made them acquainted  
“with the material facts as they truly existed.  
“Not having done so, it was a *suppressio*  
“*veri*; and whether made designedly or not,  
“is equally fatal, and the confirmation, if ob-  
“tained, will not avail him.”

In *Gilman, C. & S. R. R. Co. v. Kelly* (*supra*), the Court, speaking of an alleged ratification by stockholders of a contract between two corporations having common directors, says, at page 437:

“The ratification of the contract between  
“the railroad company and the Morgan Im-

“provement Company by the stockholders’  
 “meeting, insisted upon, constitutes no ob-  
 “stacle to the relief sought. Whatever was  
 “done at that meeting was not done with a  
 “full knowledge of all the facts. It was not  
 “then known the president and two of the  
 “directors would become members of the  
 “Morgan Improvement Company, with  
 “whom the contract had been concluded  
 “Had this important fact been known, it  
 “might have changed the conclusion of the  
 “stockholders. No ratification will estop the  
 “principal, unless he has been made aware  
 “of all the material facts and circumstances  
 “of the transaction that would in any way  
 “influence his mind or affect the value of  
 “the contract (*Hoffman Steam Coal Co. v.*  
 “*Cumberland Coal and Iron Co.*, *supra*;  
 “*Cockerell v. Cholmelly*, 1 Russ. & Mylne,  
 “418).”

(b.) It requires unanimous consent of stockholders to ratify and confirm contracts between corporations having common directors.

Cook on Corporations, Vol. II., Sec.  
658, p. 1513 (5th Ed.).

The author says, speaking of contracts between corporations having directors in common:

“Such contracts as these, however, are not  
 void, and they may be validated by the *unan-*  
*imous* vote of stockholders; moreover, if the  
 minority stockholders object to the contract,  
 the Court will consider it and will sustain it if  
 fair, and set it aside if unfair.”

In the case of unjust and unfair contracts made between corporations having common directors, the right to object to such contracts is personal to each stockholder, and to insist upon their scrutiny as to their justness and fairness by a court of equity, and upon their annulment if found to be unjust and unfair, and plainly in the interest of one corporation

and against the interest of the other, as is the fact in the case at bar.

(c.) The provisions of the Supplementary Contract of May 15th, 1882, require the unanimous consent of stockholders to any reduction of the annual rental secured to the Harlem Company by the lease of 1873 (Exhibit "B" annexed to complaint).

This contract recites that it was the intention of the parties in the contract of lease bearing date April 1st, 1873, at the time that the contract was entered into, that the terms and conditions of the first and second articles thereof should not be changed or amended by any action of the directors of the parties thereto or of either of them nor any action of the stockholders of the respective parties.

In this Supplementary Contract the Central Company covenants and agrees that the *annual* rent reserved by and to be paid under the provisions of the first and second articles of the contract of April 1st, 1873, shall be paid during the whole term of the contract at the times and in the manner therein provided, notwithstanding any future action of the directors of the parties thereto or of either of them or of the stockholders thereof. Articles first and second of the lease of April 1st, 1873, fixed the annual rent to be paid thereunder at a sum which was equivalent to eight per cent. upon the capital stock of the Harlem Company of ten million dollars and seven per cent. upon twelve million dollars of consolidated mortgage bonds, amounting in the aggregate to an annual rent of one million six hundred and forty thousand dollars.

The second supplementary contract, in direct violation of the terms of the contract of 1882, reduces the rent reserved by Articles First and Second of the lease in the sum of two hundred and twenty thousand dollars a year, or upwards of eighty-two

million dollars in the aggregate for the unexpired term of the lease.

The approval of such or any reduction of the rental reserved by Articles First and Second of the lease of 1873 by any number of the stockholders of the Harlem Company less than the whole number was a plain and manifest violation of the supplementary contract of 1882, and hence is not binding upon the plaintiffs or any minority and dissenting stockholder.

(d.) The stockholders' vote in approval of the Second Supplementary Contract should be no obstacle to the maintenance of this action, for the reason that of the shares voted in favor of approval of the contract, 65,041 shares were voted by Central directors, as follows:

J. P. Morgan.....	6,125 shares	(Stip., p. 439).
C. C. Clarke.....	100	" (Stip., p. 417).
S. D. Babcock.....	50	" (Stip., p. 416).
C. M. Depew.....	200	" (Stip., p. 418).
S. F. Barger.....	100	" (Stip., p. 417).
F. W. Vanderbilt .....	100	" (Stip., p. 424).
William K. Vanderbilt	18,718	" (Stip., p. 424).
Cornelius Vanderbilt..	39,648	" (Stip., p. 424).
<hr/>		
Total .....	65,041	"

It is plain, therefore, that the shares owned and voted by the common directors formed a material part of the majority vote.

Of the 146,519 shares which were voted in favor of the approval of the Second Supplementary Contract, 98,678 shares were voted by stockholders of the Harlem Company who were also stockholders of the Central Company (Stip., p. 439, Schedule 27).

It thus appears that the majority of the votes cast in favor of the Second Supplementary Contract by the Harlem stockholders were cast by Harlem stock-

holders who at the same time were stockholders of the Central Company.

The Referee has decided that the Second Supplementary Contract sacrificed the legal rights and was injurious to the Harlem Company and its stockholders. Such being the fact, it shocks the conscience to say that a majority vote on shares, which majority only exists by counting the votes on shares owned by stockholders who were at the same time either common directors who had perpetrated the wrong complained of, or stockholders of the Central Company, can render a contract otherwise voidable, binding upon the minority stockholders, and prevent its scrutiny by a court of equity.

It is not believed that such is the law.

Farmers' Loan & Trust Co. *vs.* N. Y.  
& N. R. Co., 150 N. Y., 410.

In that case Martin, *J.*, quoted with approval the following passage from Cook on Stock (Sec. 2, Cook on Corp., 5th Ed., § 662, p. 1528):

“ ‘The law requires of the majority of the stockholders the utmost good faith in their control and management of the corporation as regards the minority, and in this respect the majority stand in much the same attitude towards the minority that the directors sustain towards all the stockholders. Thus, where the majority are interested in another corporation, and the two corporations have contracts between them, it is fraudulent for that majority to manage the affairs of the first corporation for the benefit of the second. A court of equity will intervene and protect the minority upon an application by the latter.’ ” (2 Cook on Stock and Stockholders [3d Ed.], Sec. 662, p. 945). The same principle is stated in 1 Morawetz on Private Corporations (2d Ed., Sec. 529); 1 Beach on Private Corporations (Sec. 70); 2 Bigelow on Frauds (Sec. 645), and Beach on Mod. Eq. Juris. (Secs. 132, 686).”

In *Gamble vs. Q. C. W. Co.*, 123 N. Y., 91, Peckham, *J.*, says:

“I think that where the action of a majority is plainly a fraud upon, or, in other words, is really oppressive to the minority stockholders, and the directors and trustees have acted with and formed a part of the majority, an action may be sustained by one of the minority shareholders suing in his own behalf and that of all others coming in, etc., to enjoin the action contemplated.”

An examination of the record in the *Gamble* case will disclose that the plaintiff owned 30 shares of stock; that the capital of the defendant, the Water Company, was \$50,000, divided into 500 shares; that at the stockholders' meeting 467 shares were voted in favor of the purchase of Mullins' property, Mullins voting 131 of the 467 shares. Under these circumstances the Court held that as Mullins, the trustee, acted with and formed part of the majority, an action could be maintained by a minority stockholder and the Court examined into the justness and fairness of the transaction, and as appears by the report of the case, ordered a new trial.

In the case at bar we have a contract unjust, unfair and oppressive as to the minority stockholders. We have the common directors and trustees who planned and authorized the contract acting and voting with the majority stockholders in its approval.

A case is, therefore, presented which calls upon a court of equity to examine into the contract and scrutinize all the acts which resulted in its consummation, notwithstanding there has been a formal vote by stockholders owning a majority of the stock in its approval. Especially is this true in a case where, as in the present, the stockholders were not fully and fairly advised of their rights and interests under the lease of 1873, or apprised of all

the facts and circumstances attending the authorization of the contract by the common directors.

Among the cases supporting and illustrating the principle here contended for are the following:

A lease made by directors and ratified by a majority of stockholders in interest in a rival corporation, in which a majority of such directors and stockholders were interested, was held invalid at the suit of a minority stockholder.

*Meyer vs. S. I. Ry. Co.*, 7 N. Y. St. Rep., 245.

Where majority, in the interest of a rival corporation in which they were largely interested, abandoned a certain suit and wound up the company, such majority were held to be trustees of the profits for the minority.

*Menier vs. Hoopers Teleg. Works, L. R.*, 9 Chancery App, 350.

Contract of sale inaugurated by directors under control of purchaser and ratified by majority, set aside where plainly against the interest of the corporation.

*Chicago Hansom Cab Co. vs. Yerkes*, 141 Ill., 320.

Where dissolution of corporation has been brought about by majority directors and stockholders in the interest of a rival company, the transaction will be set aside at the suit of minority stockholder.

*Ervin vs. O. Ry. & Nav. Co.*, 27 Fed. Rep., 625.

Where two corporations are under the same voting control and such control is used so as to sacrifice the interests of one corporation and advance that of

the other, a minority stockholder can have relief against the situation.

*Jacobus vs. Am. Min. Water Mach. Co.*, 38 Misc., 371.

*McLeary vs. The Erie Teleg. & Teleph. Co.*, 38 Misc., 3.

## VI.

**The transactions of the common directors which resulted in the modification of the lease and the great reduction in rental were not conducted in good faith.**

1. The evidence is conclusive that the Second Supplementary Contract was the fruit and consummation of a pre-arranged plan, thus justifying the Referee's suspicion expressed in his opinion upon the motion to dismiss the complaint. The compromise not being a real transaction but mere machinery to furnish an apparent consideration for the modification of the lease, it follows that it could not have been made in good faith. Furthermore the discontinuance of the Hitchcock suit and the exaction of the Bond of Indemnity from the Central Company by the Harlem Directors are convincing evidence that the transactions resulting in the Second Supplementary Contract were not in good faith. Intent upon securing a reduction of rental, the common directors of the two companies acting as directors of the Central Company arranged for and purchased the discontinuance of the Hitchcock suit, the negotiations to that end being conducted by the counsel for the Harlem Company. The purchased discontinuance of the Hitchcock suit establishes,

that it was never from the very beginning the intention to submit the baseless claim preferred by the Central Company to adjudication.

In the Hitchcock suit the rights of the respective parties were fairly presented and it was ripe for adjudication. The object of the discontinuance of the suit was manifestly to prevent any adjudication of the rights of the Harlem Company under the lease, and to remove an obstacle to the execution of the Second Supplementary Contract, by which the Central Company was to *save*, in the language of its own circular to its stockholders, over two hundred thousand dollars per annum in *fixed charges*. When to the purchased discontinuance of the Hitchcock suit, which was brought in the interest of all the stockholders of the Harlem Company, there is added the extraordinary contract of indemnity, there remains no question, but that the plan disclosed by the evidence, was one throughout to benefit the Central Company at the expense of the Harlem Company.

Consider the extraordinary features of the discontinuance of the Hitchcock suit and the exaction of the contract of indemnity. The Central Company is seeking a reduction of its rental, the Central directors dominate and control both corporations; the pendency of the Hitchcock suit prevents the execution of the Second Supplementary Contract; the Board of Directors of the Harlem Company, acting under the advice of eminent counsel, Messrs. Choate and Stetson, advised against the execution of that contract until the decision of the Court, or, as the resolution expressed it, the final determination of the Hitchcock suit. The Executive Committees of the Central and Harlem Companies then assumed to act. Arrangements are made for the discontinuance of the Hitchcock suit by the payment to the plaintiff of two hundred shares of the Harlem stock, so that he should be placed in the same position he would be were the Second Supple-

mentary Contract never executed. The common directors dominate and control the Executive Committee of both the Central and Harlem Companies and are about to authorize the execution of the Second Supplementary Contract in disregard of the express direction of the Board of Directors of the Harlem Company, that it was not to be executed until the final determination of the Hitchcock suit. At the last moment they fear that what they are about to do will subject them to personal liability to the non-assenting stockholders, which could only be on the ground of its being wrongful and a breach of trust, so these dominating and controlling directors meet as the Executive Committee of the Central Company and vote to indemnify themselves as directors of the Harlem Company for authorizing the execution of the contract which is so injurious to the Harlem Company and its stockholders.

On the same day in the same room, at 10.45 o'clock A. M., these same directors meet as the Executive Committee of the Harlem Company, and after receiving the contract of indemnity, they authorize the execution of the Second Supplementary Contract which sacrifices the legal rights of the Harlem Company, as adjudged by the Referee.

The two circumstances of the purchased discontinuance of the Hitchcock suit by the Central Company, the negotiations for which were conducted by the counsel for the Harlem Company, and the execution and delivery of this extraordinary contract of indemnity, in and of themselves, constitute a just ground for vacating the Second Supplementary Contract so obtained, and clearly establish the bad faith of the entire transaction.

2. The discontinuance of the suit of the Central Company against the Harlem Company which was made the excuse for entering into the Second

Supplementary Contract, is another badge of bad faith.

3. The omission in the circular to the stockholders of the Harlem Company to advise them that an adverse decision in the Central suit would not deprive them of the right to pay off the Consolidated Mortgage Bonds by the use of the credit and resources of the Harlem Company which were amply sufficient for that purpose, is another badge of bad faith.

4. The inconsistent and contradictory circulars issued to the Central and Harlem stockholders inviting their approval of the Second Supplementary Contract is another badge of bad faith.

In the circular to the Central stockholders they were advised that the Second Supplementary Contract would result in a *saving* of over Two hundred thousand dollars per annum in fixed charges. This statement was an admission that but for the Second Supplementary Contract the Central Company would be legally obligated to pay the entire saving of interest to the Harlem Company, and it absolutely negatives the Central's claim in its action, which is made the excuse and justification of the Second Supplementary Contract in the circular to the Harlem stockholders. In the latter circular the Harlem stockholders were advised to approve the contract because of the pendency of the Central action, lest in striving to obtain all the saving in interest they might lose all. These circulars emanating from the same source, are so inconsistent and contradictory in their terms, as absolutely to negative good faith in their issue.

5. The omission in the circular to advise the Harlem ~~Directors~~ of their rights under the lease of 1873, in the other particulars heretofore pointed out, is also a badge of bad faith.

6. The absence of good faith is established not only by the acts of the common directors but also by their omissions. Had the Central Directors who constituted a majority of the Harlem Board of Directors considered only the interests of the Harlem Company, they would have pressed the suit of the Central Company against the Harlem Company to an early adjudication so that they might avail themselves of the undoubted right of the Harlem Company, if the decision was adverse, to raise the money in other ways than by a mortgage on the demised premises and pay off the Consolidated Mortgage Bonds.

It is submitted that the proceedings by which the rental which the Harlem Company was entitled to receive under the lease of 1873 has been so greatly reduced involved a violation of duty and breach of trust culminating in the demand of a contract of indemnity from the corporation which profited by the acts which form the subject matter of complaint against any claim for damages on the part of these plaintiffs or other dissenting stockholders.

## VII.

**The contention that the Second Supplementary Contract, although not executed, was completed and enforceable prior to the discontinuance of the Hitchcock suit, and the exaction of the contract of indemnity is untenable.**

All the proceedings of each of the contracting corporations contemplated a written agreement to be executed under the respective seals of the respective corporations before it should be binding. The proceedings in the respective boards of the

two corporations relative to the second supplementary contract were merely directions to their agents and officers, revocable at pleasure.

The Second Supplementary Contract was not executed until the 4th of April, 1900 (Stip., p. 21, fol. 77), the date of the discontinuance of the Central suit and the Hitchcock suit, and the contract of indemnity. It could not have been executed before that date on the part of the Harlem Company, as by express resolution of the Board of Directors of the Harlem Company its execution was prohibited until the final determination of the Hitchcock suit (Stip., pp. 477-478), and this suit, though never finally determined, was not even discontinued until April 4th, 1900 (Stip., p. 20, fol. 76).

The whole matter was inchoate until the signing, sealing and delivery of the contract. The situation is analogous to negotiations between parties the results of which are finally to be embodied in a written contract signed and sealed by the parties. No matter to what extent they agree during those negotiations there is no completed and binding contract until there is one reduced to writing and executed. That situation never existed as to this contract until April 4, 1900. No proposition it seems to us could be more simple or clearer than that.

### VIII.

**None of the considerations advanced by defendant's counsel justify the great wrong and injury to the Harlem Company resulting from the second supplementary contract and the transactions disclosed by the evidence.**

(1.) The statement at pages 12 and 13 of defendants' brief of a net annual loss to certain of the

directors and stockholders of the Harlem Company as a result of the second supplementary contract but emphasizes the injustice and unfairness of that contract.

The plaintiffs and other stockholders suffered equal loss in proportion to their Harlem holdings as did the persons named in the statement. There is, however, this difference between the plaintiffs and the stockholders and directors named in the statement, that to the extent that the stockholders and directors named were interested as stockholders of the Central Company and in the profits of the Bond Syndicate, they recouped their losses as Harlem stockholders.

(2.) The fact that the Second Supplementary Contract occasioned great damage and injury to the Harlem Company and its stockholders demanded an explanation on the part of those authorizing it in support of the claim of good faith made on their behalf. The contract being manifestly unjust, unfair and injurious to the Harlem Company and having been authorized by common directors of the two companies, the burden was on them to justify it and their acts in regard to it.

Cumberland Coal Co. *v.* Sherman, 30 Barb., 553, 573-574.

Sage *v.* Culver, 147 N. Y., 241, 247.

Currier *v.* N. Y., W. S. & B. R. Co., 35 Hun, 355, 357.

Cumberland Coal Co. *v.* Parish, 42 Md., 598.

Meeker *v.* Winthrop Iron Co., 17 Fed. Rep., 48, 51.

Flint *v.* P. M. Ry. Co., 14 Mich., 477, 487-488.

3 Greenl. on Ev. (16th Ed.), Sec. 253, pp. 240-241.

2 Beach on Trusts, Sec. 520.

The rule is thus laid down in *Sage vs. Culver* (*supra*), page 247: “When a trustee or  
 “the officer or director of a corporation deals  
 “with himself as an individual, or in the character  
 “of trustee, director or officer of another corporation,  
 “with respect to the funds, securities or property  
 “of the corporation, the transaction is at least  
 “open to question by the corporation, or, in a proper  
 “case, by its stockholders, and the trustee is bound  
 “to explain the transaction and show that the  
 “same was fair and that no undue advantage has  
 “been taken by him of his position for his own advantage  
 “or the advantage of some other corporation  
 “in which he has an interest.”

None of the directors was called as a witness by the defendants to explain or justify any of the transactions resulting in the Second Supplementary Contract, or the discontinuance of the Hitchcock action, or the exaction of the contract of indemnity.

These transactions and the manifest injustice, unfairness and oppressiveness of the Second Supplementary Contract call for explanation and justification.

The Trustees who were parties to the transactions and who authorized the Second Supplementary Contract remain silent. They decline to submit themselves to the fire of cross-examination and shelter themselves behind the pleas of able and astute counsel whose only excuse for not calling them is that to do so would delay the trial.

Under the circumstances of this case the silence of the Trustees is strong evidence of the absence of good faith. The Trustees alone could vindicate their action, disclose their motive, and they decline to attempt the vindication or make the disclosure.

The omission to produce the evidence of the Trustees as to the transactions under consideration raises a strong presumption against their good faith.

Starkie on Evidence, Vol. 1, p. 54.

Kirby vs. Tallmadge, 160 U. S. Rep., 379-380.

In *Kirby vs. Tallmadge* (*supra*) it is said:

“It is stated by Mr. Starkie in his work on Evidence (Vol. 1, p. 54), ‘The conduct of the party in omitting to produce that evidence in the elucidation of the subject matter in dispute which is within his power, and which rests peculiarly within his own knowledge, frequently affords occasion for presumptions against him, since it raises strong suspicion that such evidence, if adduced, would operate to his prejudice.’”

But even if it be assumed that the burden is on the plaintiffs to establish the unfairness, injustice and oppressiveness of the contract in question, that burden has been fully met, since it is apparent upon the face of the transactions that the solicitude and care of the Central directors, who were also directors of the Harlem Company, was the interest of the Central Company and not that of the Harlem Company.

(3.) The claim, that because none of the stockholders who voted for the approval of the Second Supplementary Contract have since objected thereto, the plaintiffs are estopped from so objecting, is without force.

It nowhere appears that those stockholders so voting (other than the Central Directors) were apprised of their rights, or of the injury done them by the suppression in the circular issued to them recommending the approval of the contract, of all information as to their rights under the lease of 1873 and of other important matters affecting their rights and interests to which we have already referred. It is undisputed too, that upwards of 65,000 of the shares of stock voted in favor of the Second Supplementary Contract were cast by Central Directors; and that upwards of 98,000 were cast by stockholders of the Harlem Company who were at the same time stockholders of the Central Company (Stip., p. 439, Schedule 27). Indeed, the defendants

admit by the schedule on page 23 of their brief that of the votes in favor of the Second Supplementary Contract 84,097 shares were owned by shareholders having direct or indirect interest in the Central bonds, or being common directors, or by shareholders having greater interest in the Central than in the Harlem Company.

(4.) Equally untenable is the claim that stockholders accepting a dividend under the Second Supplementary Contract are estopped from questioning its validity. The Referee has adjudged that under the terms of the lease, the Harlem Company was entitled to the entire saving of interest effected by the refunding of the Consolidated Mortgage Bonds. It is difficult to perceive how the acceptance of a less sum than is due the Harlem Company by some of its stockholders can estop a stockholder in no wise consenting to the transaction from claiming on behalf of the Harlem Company as its representative, that the Central Company should pay to it what was legally due; especially as in this case it affirmatively appears that the stockholders so accepting the less sum were not fully apprised of their rights, and of the facts and circumstances of the transactions which resulted in the Second Supplementary Contract. As the Second Supplementary Contract was unjust and unfair, and oppressive to the minority stockholders, it is confidently submitted that it was beyond the power of a majority of the stockholders, or of any number less than the whole, to give it validity as against a single objecting stockholder, either by their votes, or the acceptance of benefits under it, or acquiescence in any form or by any act.

(5.) The effort of counsel for the defendants to establish the good faith, fairness and justice of the transactions resulting in the Second Supplementary Contract by iterating and reiterating that Mr. Milburn in his argument omitted to indulge in invective

tive and abuse in speaking of the acts and conduct which has worked such wrong and injury to the Harlem Company, utterly fails. Fraud is never predicated upon invective or abuse; but upon facts. The transactions disclosed by the evidence when considered in the light of their consequences to the Harlem Company, must impress every impartial mind with the conviction that the rights of the Harlem Company were sacrificed in the interests of the Central Company.

If the Second Supplementary Contract was a fair and impartial arrangement between the two companies why did the Central Company procure the discontinuance of the Hitcock suit and indemnify the directors of the Harlem Company. Can a precedent be found for one company furnishing personal indemnity to the directors of another company in order to induce them to execute a contract which benefits the indemnifying company in the annual sum of \$220,000. When the Directors of the Harlem Company demanded and received this indemnity before they would consent to the execution of the contract it was an admission on their part that the Central Company was a gainer by the transaction at the expense of the Harlem Company. Surely the exaction and receipt of this indemnity for their acts as Trustees, was such an act that a Court of Equity will not allow a contract so obtained to stand. In the face of the admitted facts epithet or invective or characterization of the acts which form the subject matter of complaint was entirely unnecessary, and the maxim *res ipsa loquitur* applies with full force, as do also the observations of Mr. Justice Patterson in *Ives v. Smith*, 3 N. Y. Supplt., 645; *affd.*, 8 N. Y. Supplt., 46.

In that case (p. 652) Justice Patterson observes:

“ There are expressions in the books, particularly in the English cases, which give  
 “ force to the view that the acts of directors  
 “ will not be restrained by a court of equity

“ unless such acts are *ultra vires* or are fraud-  
 “ ulent in their character or consequences,  
 “ *but the word ‘fraudulent’ is very elastic,*  
 “ *and has not been confined, by any case of*  
 “ *controlling authority, only to acts involving*  
 “ *turpitude or conscious moral delinquency.*  
 “ Fraud may be predicable of gross neglect of  
 “ duty, and the squandering of corporate  
 “ assets may amount to fraud, and the arm  
 “ of a court of equity should not be shortened  
 “ to disable it from reaching such cases.”

## IX.

**In none of the cases cited by counsel for the defendants did it appear that the acts of the common or interested directors were unjust, unfair or oppressive to the minority stockholders.**

A review and synopsis of those cases will be found annexed to this brief (see Appendix).

## X.

**The second supplementary contract should be vacated.**

JOHN G. MILBURN,  
 WILLIAM C. TRULL,  
 CHARLES E. MILLER,  
 RICHARD L. SWEETZ,  
 Of Counsel for Plaintiffs.

## APPENDIX.

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### REVIEW OF CASES ON DEFENDANT'S BRIEF.

The references on the margin are to pages of defendant's argument.

*Guidel v. N. Y. L. E. & W. R. R. Co.*, 9 N. Y., P. 29. St. Rep. 265, affirmed on appeal below, 120 N. Y., P. 84. 649, was an action (p. 27) "for damages for *fraudulent representations* concerning work to be performed under a contract between the plaintiff and the defendant." The only evidence of such alleged fraudulent representations was a misdescription of the work in a plan prepared by defendant's engineer and inspected by plaintiffs before the contract was made, with nothing to show that this misdescription was intentional. The Court held that the evidence did not show that the misdescription might not be due to mistake, and, therefore, did not show fraud.

*People v. Kelly*, 11 App. Div., 495; App. Div., P. 29. 153 N. Y., 651, was a criminal case where the Court applied the presumption of innocence.

*Synnott v. Cumberland Bldg. Loan Assn.*, 117 P. 45. Fed. Rep., 379, was an attack by certain stockholders on certain acts of the corporations, taken at a stockholders' meeting *where plaintiff's proxy was present and voted for the action attacked*. The plaintiff claimed to be entitled to repudiate her proxy's act, on the ground that the notice of the meeting where the action was taken, was insufficient, and that the proxy could not waive the insufficiency of the notice, the Court held that, whether the proxy could waive this or not, the plaintiff could not sit by over a year and then complain.

*Gamble v. Queens Co. Water Wks. Co.*, 123 N. Y., P. 60. 91, the Court expressly says (p. 97) that Mullins, the director whose property was sold to the corporation—the transaction attacked—did not act on the other P. XXXV.

side (*i. e.*, as a trustee or representative of the corporation).

Also, the Court found (pp. 102-105), that the contract was not shown to be an unfair one. The opinion (p. 98) shows that the majority stockholders cannot vote to the evident detriment of the corporation, and that a court of equity will scrutinize the majority's action to see if it be fair or not, at the suit of a minority stockholder.

P. 61.  
P. CV.

*Hodge v. U. S. Steel Corp.*, 54 St. Rep., 1, at p. 3, the Court says:

On page 2 the Court quite plainly approves of the transaction.

“There is an entire absence in the case of anything to show a taint of fraud, *or an attempt to conceal from the shareholders any fact which would have influenced their action.* That the entire proceeding was conducted with good faith, without concealment, *and with fairness to both parties*, is evinced by the facts”; that no other stockholder objected.

Also (p. 2), a by-law of the Steel Corporation provided for the submission to the shareholders for approval or ratification of any contract or act, and further provided that ratification or approval by a majority should be as binding as though ratified or approved by every stockholder. This by-law, the Court said (p. 2), “could not amplify the powers of the corporation, or operate to validate any act *ultra vires* of the corporation, *but it enabled the stockholders by a majority vote to ratify any contract which the entire body of stockholders or the corporation might lawfully make.*”

Also, there was express notice of Mr. Morgan's adverse interest (see Deft.'s Brief, p. LXI.).

P. 62.

*Northwest Transp. Co. v. Beatty*, L. R., 12 App. Cas., 589, the Court found the transaction in question a fair one (p. 596, 4th paragraph), and on page 600, says:

“It may be quite right that, in such a case, the opposing minority should be able, in a

suit like this, to challenge the transaction, and show that it is an improper one, and to be (p. 601) freed from the objection that a suit with such an object can only be maintained by the company itself."

In *Bjorngaard v. Goodhue Co. Bk.*, 49 Minn., P. 62. 483, the fairness of the transaction was not questioned at all; the plaintiff stood on the proposition that the directors adversely interested *could not*, as majority stockholders, legally vote to ratify the purchase of property from themselves, and the Court held against the proposition.

The Court says (p. 487) that the

"majority stockholders cannot use their power of voting for the purpose of defrauding the minority,"

and quote, with approval, the Court's *dictum* in the *Gamble* case to the effect that a court of equity will look into the transaction at the suit of the minority.

In *Barlow v. Earle, L. R.*, 1902 App. Cas., 83, P. 63. the plaintiffs, minority shareholders, sought to compel the majority to distribute certain surplus profits, rather than investing them in a certain way. The Court held this was a matter of internal management with which the Court would not interfere.

There was also brought in question (pp. 98, 99) a sale by the president to the corporation of a certain plant at a large profit, and the plaintiffs sought to have the president declared a trustee of the profit. This, the Court said, was not the right remedy (p. 99). "To rescind the sale is one thing, but to force on the vendor a contract to sell at another price is a totally different thing."

In *Socorro Mountain Mfg. Co. v. Treston*, 17 Misc., 220, CHESTER, J., at Special Term, had under P. CVL. consideration a motion to discontinue an action. It appeared that the corporation was insolvent, and

that a majority of the stockholders had, at the annual meeting, voted to discontinue the action. It does not appear who opposed the motion, but presumably it was the plaintiff's attorneys, as the Court said (p. 221) the action "should not be discontinued against the consent of plaintiff's attorneys, without securing them for their lawful charges, etc." It would seem, therefore, that these attorneys took the objection that the majority stockholders' action was not valid, as some of them were personally interested as defendants. *It does not appear that any stockholder objected, nor is there the slightest suggestion that the discontinuance was improper.*

P. 63.  
CXVII.  
CXXII.

In *Windmuller v. Standard Distilling & Distributing Co.*, 114 Fed. Rep., 491, and 115 Fed. Rep., 748, the plaintiffs (minority stockholders) did not complain of an injury to the corporation by the action of the adversely-interested majority in voting for a dissolution, but rather of an injury to *each one* of them (the complainants) by reason of the loss of the guaranty on his stock.

JUDGE KIRKPATRICK says (114 Fed. Rep., p. 495):

"In the case at bar, the Court is not in possession of facts which would enable them to determine whether *the interests of the corporation, as distinct from the interests of the individual shareholders*, require that it should be dissolved."

and JUDGE LACOMBE says (115 Fed. Rep., p. 748):

"Practically the whole case of the plaintiffs rests on the proposition that majority stockholders who are individually interested in the abrogation of this contract may not vote for a dissolution of the corporation, *because their doing so will indirectly abrogate the contract which minority stockholders find it for their individual interest to keep alive.*"

*In Beveridge v. N. Y. El. R. R. Co.*, 112 N. Y., 1, the main question was whether the Manhattan's contract to pay to the New York Elevated R. R. Co. an amount equal to ten per centum on the capital stock of the New York Co. (in which plaintiff was a minority stockholder) was with the stockholders of the New York Co., or for their benefit.

At p. 29, the Court says:

“ The gravamen of his (the plaintiff's) complaint is, that the contract in the lease of 1879 inured to his benefit, and could not be discharged or modified by agreement between the companies, and is one which he can enforce; and that, when he commenced his suit, the contract was in full force; and that the New York Company is entitled to recover from the Manhattan Company the ten per cent. payable under its provisions since July, 1881. I (p. 30) have undertaken to show how he is in error in the propositions on which he claims a right to maintain his action.”

And at the bottom of page 20, and on page 21, the Court states specifically that the plaintiff's claim was that the “ ten per cent. agreement ” inured to his benefit, “ so as to warrant the interposition of a Court of Equity in his favor, compelling a performance of the agreement in the fullest import.”

The Court's conclusion was that the contract was with the New York Company; that, whether dividends should be paid was within the directors' discretion; and so plaintiff had no equitable right.

It was contended that the plaintiff had a right under the lease, as the consent of the stockholders was necessary to the lease. This the Court held unsound, on the ground that no such consent was necessary (pp. 21, 24).

It was further contended on behalf of the plaintiff that the action of the directors in voting to modify the leases by reducing the rental was not within their powers, and so not binding on the plaintiff. The Court held to the contrary, pointing out that it

was (p. 28) “not an unreasonable or improper exercise of business discretion, *in view of the embarrassments in which the insolvency of the Manhattan Company had involved itself and its lessors.*”

“The long quotations on defendant’s brief are from the Court’s discussion of this point.”

Of course, the *insolvency* of the Manhattan Company justified the action of the New York directors in reducing the rent. The question was, as the Court says (p. 28), one “lying in the exercise of business judgment.”

P. 80, 123.  
LXXVIII

In *Shaw v. Davis*, 78 Md., 308:

The Court held that a minority stockholder cannot complain of the majority’s action in making a lease (even where the majority are interested as majority stockholders in the lessee corporation) unless the lease was *ultra vires*, fraudulent or illegal—the right of action for errors being in the corporation.

What the Court means by “fraudulent,” however, appears on page 328, where it says:

“There has been literally nothing adduced  
“to show that the alleged errors were fraudulent or *designedly* committed, with a view  
“of benefiting the stockholders of the Piedmont and Cumberland Company at the expense of the stockholders of the West Virginia Central Company.”

The gist of the whole argument of the Court is, that it will not interfere in the internal management of a corporation, even when it comes to dealings with another corporation in which the majority control, unless the contemplated action is so plainly injurious to the minority as to leave no doubt that the corporation’s interests have been sacrificed. The Court means, by “fraudulent,” such action, just as Mr. Cook says (2 Cook on Corp., 5th Edn., Sec. 662, p. 1528), that it is fraudulent for the majority to

manage the affairs of one corporation in the interest of another one in which they are interested.

Unquestionably the same idea existed as expressed in *F. L. & Tr. Co. v. N. Y. & N. R. Co.* (150 N. Y., 410), in the use of the words "fraudulent or oppressive."

*Pauly v. Pauly*, 107 Cal., 8:

P. 78.

The balance of the headnote, a part of which defendant quotes on page 78 of his brief (reply to Mr. Milburn), is:

" , and, if the relations of the parties has not  
 " been abused, it constitutes no bar to a re-  
 " covery for moneys advanced by the bank,  
 " and used for the benefit of the Cable Com-  
 " pany."

*Shultry v. Hoagland*, 84 N. Y., 464:

P. 84.

From which defendants quote, on page 84 of their brief, was an action to set aside a fraudulent assignment.

*San Diego, O. T. & Pac. Beach R. R. Co. v. Pacific Beach Co.*, 112 Calif., 53:

(P. 58.) The Court says:

"The contract seems to have been a fair, open one, and carried into effect before the eyes of all persons interested."

(P. 60.) Assuming the contract to be voidable, the Court says:

"that it is clear it was not avoided but was ratified. The appellant had paid interest on the notes sued on. No objection on part of appellant to paying the notes was made until after the time for performance was past and respondent had performed all the covenants."

The action was by plaintiff corporation against defendant corporation on the latter's notes, given in

pursuance of a contract by which the plaintiff agreed to run the railroad as defendant should direct. The contract was made by boards of directors having a common majority. The transaction was fair, and had been reported to at least two annual meetings and one adjourned meeting of the defendant stockholders and approved by more than a majority. The plaintiff had performed its part of the agreement, and the defendant, when payment of the notes was demanded, for the first time, set up the alleged invalidity of the transaction by reason of the common directors.

(P. 63.) The Court noted:

“That the action was *not* one by individual stockholders to set aside a contract by the corporation, but that the point was made by the corporation itself seeking to violate its own obligation.”

On page 85 of defendant's brief is quoted, a part of a sentence, from page 59 of this case, thus:

“Common directors owe the same fidelity to both corporations, and there is no presumption that they will deal unfairly with each other.”

The balance of the sentence is:

“; therefore, their acts as such common directors are not void.”

In *Dunphy v. Traveller Newspaper Association et al.*, 146 Mass., 495, the Court held that a minority stockholder did not show a sufficient excuse for seeking redress of the Court, rather than of the corporation itself, or its Board of Directors, where there was no allegation that he had attempted to move the directors, even where he alleged that the wrongdoers were in control of a majority of the stock.

In explaining the requirement of such an allegation the Court said: “What defendant's counsel

quote, on page 85 of their brief, that 'it is always assumed until the contrary appears that they (corporations) and their officers obey the law, and act in good faith towards all their members.'"

*Mac Naughten v. Osgood*, 41 Hun, 109; *revd. on other grounds*, 114 N. Y., 574, was a minority stockholder's action to restrain the officers of a corporation from paying to themselves salaries fixed by them in their own favor, and to refund the amount already paid.

The only fact shown was that three directors voted to fix their own salaries as president, vice-president, and secretary and treasurer. Judge Landon said (p. 111):

"Under the circumstances, the corporation should be adjudged to do and receive what the evidence shows it is just that it should do and receive."

He then goes on to say that, while in an action by the corporation the burden would rest on the directors of overthrowing the presumption of unfairness arising from their dealing with themselves, this did not apply in a stockholder's action, where the plaintiff must show that the corporation was being despoiled and was in the hands of the despoilers. The mere fact of the directors having voted salaries to themselves does not show an injury to the corporation, Judge Landon says, as it is conceivable that the services rendered for the salaries were the most valuable that could be secured.

*Fender v. Lushington*, L. R. 6, Ch. Div., 70, was an action by a stockholder to have it adjudged that the register of shareholders was the only evidence of whether or not a man had the right to vote. It was held that the register *was* the sole criterion in determining the right to vote, and Sir George Jessel said, in opening his opinion (pp. 75-76), that it made no difference what the motive of the voter was, the question to be determined was, Who had the legal right to vote.

*Twin Lick Oil Co. v. Marbury*, 91 U. S., 587, was a case where a director and stockholder loaned money to his company, taking a note and mortgage; upon default in payment thereof, the property mortgaged was sold and bought in by the director. The corporation sued the director for an accounting, and asked that he be decreed to hold the property in trust for the corporation.

As to the nature of the transaction the Court says (p. 588):

“It is sufficient to say that we are satisfied that the defendant loaned the money to the corporation in good faith, and honestly to assist it in its business in an hour of extreme embarrassment, and took just such security as any other man would have taken; that when his money became due, and there was no apparent probability of the company paying it at any time, the property was sold by the trustee, and bought in by defendant at a fair and open sale *and at a reasonable price; that, in short, there was neither actual fraud nor oppression*; no advantage was taken of defendant's position as director, or of any matter known to him at the time of the sale, affecting the value of the property, which was not as well known to others interested as it was to himself; and that the sale and purchase was the only mode left to defendant to make his money.”

*Booth v. Robinson*, 55 Md., 419, was an action by stockholders against some of its directors, who were common directors in another corporation, to obtain redress for what is alleged to have been the loss in the value of plaintiff's shares by reason of certain and fraudulent management of the corporation by the directors.

In other words, the question there was one of personal liability of the directors, and it was held that plaintiff must show fraud, or malfeasance, or such gross negligence as would amount to a breach of trust.

*Hart v. O. & L. C. R. R. Co.*, 89 Hun, 316, went off partly on defects in pleading. The Court

said that the complaint did not show the relative values of the O. & L. C. R. R. Co.'s stock and of the Central Vermont R. R. Co.'s stock, and that, therefore, the Court could not say that a great disproportion of the two companies in the ratio of new stock (of the consolidation company) for old stock, was manifestly against the interest of the O. & L. C. R. R. Co.

*Barr v. N. Y., L. E. & W. R. R. Co.*, 125 N. Y., 263, was simply a case where the Erie Railroad had enjoyed for several years the fruits of a lease made by common directors in its interest, and then proposed to make no further payments under the lease, setting up the vice in the original transaction. This the Court held it could not do.

*In Genesee Valley & Wyoming Ry. Co. v. Retsof Mining Co.*, 15 Misc., 187.

There is not even a suggestion that the contract modifying the lease was unfair; it was contended that the contract was of no force because executed by the directors of the defendant, who were at the time interested in the plaintiff corporation, and because it was subsequently revoked by a resolution of defendant's stockholders.

*In Burden v. Burden*, 8 App. Div., 160; *affd.* 159 N. Y., 287.

The trial Judge found (p. 171) that the transactions attacked did not result in any pecuniary injury to the plaintiff or a stockholder.

*In Kelly v. Newburyport & A. H. R. R. Co.*, 141 Mass., 496.

The corporation was sued on certain of its notes, given to two of its directors in payment for certain work in the building of its road. The price was fair and the road was well built. The notes were given on authority of the stockholders, who voted to authorize the directors to make any settlement with the persons building the road.

All the Court held was that the facts showed a ratification—the corporation having held and operated the road for many years.

*Nye v. Storer*, 168 Mass., 53, was an action by a stockholder and director to set aside a lease to an association of individuals consisting of the directors other than the plaintiff (p. 54). “At a subsequent meeting of the corporation, at which all the stockholders were represented, the lease was ratified.”

The Court first held that the lease was not illegal.

Then, considering the “only other objection to the lease”—that “it was fraudulent”—the Court said that there were no fraudulent acts charged. That *it was not charged that the price to be paid was inadequate*.

*Jesup v. Ill. Cent. R. Co.*, 43 Fed. Rep., 483. It appeared that the two boards (having common directors, less than a majority) fixed the rental in accordance with the report of competent and disinterested experts to whom the question had been referred.

The mere fact that the rental turned out to be larger than it ought to be does not justify presumption of fraud.

In this case no move was made to cancel the lease for 20 years.

In *Twin-Lick Oil Co. v. Marburg*, 91 U. S., 587, the Court says at page 588:

“That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealings with the subject matters of his trust or agency, and with the beneficiary or party whose interest is intrusted to his care *is viewed with jealousy by the courts, and may be set aside on slight grounds*, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this Court and others.”





























# New York Supreme Court,

COUNTY OF NEW YORK.

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CONTINENTAL INSURANCE COMPANY

*against*

NEW YORK AND HARLEM RAILROAD COMPANY and  
NEW YORK CENTRAL AND HUDSON RIVER  
RAILROAD COMPANY.

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Before the HON. CHARLES ANDREWS, Referee.

February, 1904.

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## Defendants' Argument, Reply and Cases on Final Submission.

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WILLIAM B. HORNBLOWER,  
FRANCIS LYNDE STETSON,  
FRANK LOOMIS,  
HENRY B. ANDERSON,

*Counsel for Defendants.*

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NEW YORK :  
C. G. BURGOYNE, WALKER AND CENTRE STS.  
1904.



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# Supreme Court,

COUNTY OF NEW YORK.

CONTINENTAL INSURANCE COMPANY,  
Plaintiff,

AGAINST

NEW YORK AND HARLEM RAILROAD  
COMPANY and NEW YORK CENTRAL  
AND HUDSON RIVER RAILROAD  
COMPANY,

Defendants.

Before Hon.  
CHARLES ANDREWS,  
Referee.  
14 January, 1904.

## **BRIEF FOR DEFENDANTS, ON SUM- MING UP.**

### **Synopsis.**

I. The subject matter of this suit.

II. Construction of lease sufficiently doubtful to justify compromise agreement, if made in good faith.

III. Allegations of bad faith unsustained by testimony, but, on the contrary, affirmatively disproved.

IV. No question of constructive fraud in case by reason of common directorship in two companies, the stockholders of the Harlem Company having adopted the contract, in a stockholders' meeting specially called for that purpose, by an overwhelming vote, exclusive of the vote of the common directors.

V. The vast majority of the Harlem stockholders have acquiesced in the compromise agreement and

have accepted for over three years their increased dividends thereunder.

[References hereinafter made to pages, refer to pages of the printed stipulation as to facts. References to articles and schedules, likewise refer to articles of the printed stipulation as to facts and to the schedules thereto annexed. Where stenographer's minutes of the trial are referred to, they will be designated as Sten. Min.]

## I.

### **The Subject Matter of this Suit.**

This is not a suit for an accounting against directors claimed to have been derelict in their duties to the corporation. No one of the directors of the Harlem Railroad is made a party defendant. The only defendants to the suit are the two corporations, the New York and Harlem Railroad Company and the New York Central and Hudson River Railroad Company.

This is not a suit to set aside the contracts made by the Harlem Company and the Central Company with Messrs. J. P. Morgan & Co. and J. S. Morgan & Co. for the sale of the refunding bonds of the Harlem Company and the Central Company. The members of those firms are not parties defendant, nor could any decree be made herein which would be binding upon them, as firms or as individuals. If the complaint had prayed relief as to those contracts, it would have been demurrable for defect of parties defendant.

The sole purpose of this suit is to obtain a decree to the effect that a certain contract entered into between the two corporations who are parties defendant to this suit was a fraud upon the stockholders of the Harlem Railroad Company, and should therefore be set aside. That contract is known as the second supplementary contract, and is also referred to as the compromise agreement between the two companies.

It is claimed that this contract was made by the directors of the Harlem Company in wanton violation of the rights of the stockholders of that company, and in the interest of the Central Railroad Company and its stockholders, and should therefore be set aside.

The contracts made with the Morgan firms for the sale of the refunding bonds of the Harlem Company and the Central Company are incidentally referred to in the complaint as showing a motive for the alleged wrongful conduct of the Harlem directors. These contracts are, therefore, material in this suit only as bearing upon the *bona fides* of the agreement which is the subject-matter of this suit, viz., the second supplementary contract.

## II.

**The construction of the language of the lease of the Harlem Railroad Company to the Central Railroad Company is sufficiently doubtful to justify the compromise agreement between the two companies, if entered into in good faith.**

It is true that heretofore, in his opinion handed down denying the motion to dismiss the complaint as insufficient in law, at the opening of the trial, the Referee has stated his conclusion to the effect that the true construction of the lease is that which was contended for by Messrs. Stetson and Choate as counsel for the Harlem Railroad Company, in the litigation between the two companies, and which was set forth in Mr. Stetson's opinion of December, 1896. It is true also, however, that the Referee held, in substance, that the question of the construction of the lease was not so entirely clear from doubt that a compromise made in good faith would be beyond the

powers of the Boards of Directors of the two companies. The Referee says, in his opinion :

*“ The power of two corporations to settle and  
 “ adjust controversies arising between them, by com-  
 “ promise of conflicting claims, inheres as a corpo-  
 “ rate power in each, and may be exercised by their  
 “ Boards of Directors acting honestly and in good  
 “ faith with a view to compose a difference founded  
 “ upon reasonable grounds. A settlement so made  
 “ cannot be disputed merely because one of the  
 “ parties to the controversy has been accorded a  
 “ right or has secured by the settlement a recog-  
 “ nition of a claim to which (by) application of  
 “ the rules of law to the facts, he would not be en-  
 “ titled. In general, in all controversies, one  
 “ party is right and the other wrong. The facts  
 “ only may be disputed, or there may be a dis-  
 “ pute as to the law upon conceded facts. The  
 “ parties undertake, by the compromise, to adjust  
 “ the dispute, each by surrendering something of  
 “ his claim, and when the adjustment is made, it  
 “ cannot be re-opened at the instance of a party  
 “ who may be subsequently dissatisfied with the  
 “ settlement, unless he is able to allege and  
 “ establish some ground for interference by a court  
 “ of equity. But there must have been a real dis-  
 “ pute and not a mere colorable one, or else there  
 “ would be no consideration for the surrender by  
 “ the compromise of any right or claim existing  
 “ when the settlement was undertaken.*

*“ It is insisted in behalf of the plaintiff that the  
 “ claim on the part of the Central Company that  
 “ under the lease the Harlem Company had no  
 “ right to issue its bonds for the purpose of pay-  
 “ ing the Consolidated Mortgage Bonds, without  
 “ the consent of the Central Company, was so  
 “ palpably unfounded that it furnished no reason-  
 “ able ground for a compromise, and no con-  
 “ sideration for the agreement. While my  
 “ conclusion is that the Harlem Company was  
 “ correct in its construction of the lease,*

“and that thereunder it had the right to  
 “issue new bonds secured by mortgage on  
 “the railroad property, for the purpose  
 “stated, without the consent of the Central Com-  
 “pany, *nevertheless, I am not prepared to hold*  
 “*that the question is so clear and indisputable as*  
 “*to preclude controversy, or to lead of necessity*  
 “to the conclusion that the claim of the Central  
 “Company was put forward as a mere pretext to  
 “cover a design to deprive the Harlem Company,  
 “through a pretended compromise, of the full  
 “benefit of the first clause of the Sixth Article of  
 “the lease. *I am of the opinion that the validity*  
 “*of the compromise agreement can not be assailed*  
 “*on the sole ground that the right of the Harlem*  
 “*Company was too clear for argument.*”

At the time when the Referee handed down this opinion, there was nothing before him to show that any lawyer had given any opinion contrary to that asserted by the plaintiffs in this suit, with regard to the true construction of the lease of 1873. The Referee was bound to assume, as he did assume, on the motion to dismiss the complaint, that the allegations of the complaint stated the truth, the whole truth, and nothing but the truth.

The complaint set forth that *on or shortly before April 14, 1897*, the Harlem Company had been advised by *its* counsel that they had the right to refund their bonded debt, and thereafter to receive 7 per cent. per annum from the Central Company for the remaining term of the lease. The complaint ignored the fact that any other opinion had theretofore been given by any counsel to the Harlem Company or that any opinion had been given to the Central Company. It appears now by the stipulated facts in this case that a contrary opinion had been given by the General Counsel of the Harlem Railroad in an official communication directed to the President of the Harlem Railroad Company, at his request, as early as March, 1896, more than a year before April 14, 1897.

It appears further by the stipulated facts in this case that upon May 17, 1897, a contrary opinion also was given in response to a request by the president of the New York Central and Hudson River Railroad Company, not only by its general counsel Mr. Loomis but by associated counsel specially called in to advise in the matter, Messrs. Edward J. Phelps and Ashbel Green (Schedule 2, pp. 53, 54).

The only justification for the allegation of the complaint with regard to the advice of counsel to the Harlem Company "*on or shortly before April 14, 1897*," is the opinion given by Mr. Stetson, in December, 1896, to Mr. Twombly, as to which it is stipulated in the stipulation of facts (Article 17) that Mr. Stetson gave this opinion to Mr. Twombly "for submission to one or more of the Harlem directors." The testimony of Mr. Twombly, called as a witness for the plaintiffs, is that he was not a director at that time of either company; that Mr. Stetson was his individual counsel; that, knowing there was a controversy raised with regard to the construction of the lease, and being interested in the good name of the Vanderbilt family, of which his wife was a member, he asked Mr. Stetson for his opinion on the questions in controversy in order that he might do what he could to prevent any action by the Vanderbilts which might subject them to criticism.

It does appear that subsequently, and after litigation between the two companies had been instituted, Mr. Stetson and Mr. Joseph H. Choate were retained as counsel for the Harlem Company in that litigation, and, giving the plaintiffs the benefit of this fact, we have the circumstance that *subsequently* to (*and not "on or shortly before"*) April 14, 1897, the Harlem Company was advised by its counsel that the construction of the lease now contended for by plaintiffs was the true construction. It appears, however, that Mr. Stetson, one of the counsel who *subsequently* to April 14th, 1897, was retained by the Harlem Company, as counsel in its litigation "*on or shortly before April 14th, 1897*," to wit, on April 9th, did advise Mr. Twombly that the construction of the lease

was not so free from doubt, but that a Court might decide in favor of the Central and against the Harlem contention, and that a compromise between the two companies would be proper and legal, and he even went so far as to suggest a compromise, by which each company should give up substantially one-half of the amount in dispute, by way of annual payments to the stockholders of the Harlem Railroad (see letter of Mr. Stetson to Mr. Twombly, dated April 9, 1897, pp. 59 to 61).

If, upon the case as presented by the complaint, and upon what was held to be a demurrer by the defendants upon the motion to dismiss at the opening of the trial, and in the absence of any allegations in the complaint that any reputable counsel had expressed any opinion adverse to that contended for by the plaintiffs in this suit, the Referee could still hold that the question was one *not "so clear and indisputable as to preclude controversy, or to lead of necessity to the conclusion that the claim of the Central Company was to put forward as a mere pretext,"* much more must this be the opinion of the Referee when, as now, it appears by the undisputed evidence in this case and by the stipulation of the attorney for the plaintiffs, that the opinion of four distinguished and reputable counsel, viz., Messrs. Anderson, Phelps, Loomis and Green, had been expressed in favor of the Central contention and against the Harlem contention.

As we have already pointed out, and as is stipulated in this case, the opinion of Mr. Henry H. Anderson, was an official opinion delivered by the general counsel of the Harlem railroad to the president of that company, in response to a request from the president of that company. If any question of good faith were open in this case with regard to the conduct of the Harlem directors, it would seem to be the question of their good faith in acting directly in opposition to the advice of their general counsel, and in defending a litigation by the Central company, which litigation was in accordance with such advice. The directors of the Harlem company, however, were evidently so desirous

of doing their full duty by their stockholders that, notwithstanding the advice of their general counsel, having been informed that a reputable and prominent member of this bar had given contrary advice, resolved to assert the rights of the Harlem stockholders, and to defend any claim made by the Central Company in opposition thereto—hence came the litigation.

We are informed that Mr. Henry H. Anderson died in September, 1896. At the time, therefore, of the passage of the resolutions of April, 1897, he was no longer their legal adviser, nor does it appear that they had any legal adviser. It must be assumed that they acted upon their own judgment and sense of duty, in passing the resolutions asserting the alleged rights of the Harlem Company, and in subsequently determining to defend the suit about to be brought by the Central Company, and in retaining counsel for that defense. They further showed their good faith and sense of duty by retaining as counsel for the Harlem Company the lawyer who had given a written opinion to Mr. Twombly against the claim of the Central Company, and they subsequently authorized him to retain as his associate counsel for the defense of the suit, Mr. Joseph H. Choate, then the acknowledged leader of the active trial Bar of the State of New York.

That the controversy, however, was one as to the merits of which there might be, and was an honest difference of opinion, follows conclusively from the facts admitted in this case to the effect that there *was* a difference of opinion between eminent counsel, the honesty of which has been in no respect impeached.

Indeed, excluding the opinion of Mr. Trull, which concededly was given to his client, the Continental Insurance Company, and not to the Harlem Railroad, there was the single opinion of Mr. Stetson given to Mr. Twombly, as against the opinion of four lawyers given in the other direction—viz.: Messrs. Anderson, Phelps, Loomis and Green—Mr. Anderson being the general counsel and the official adviser of the Harlem Company. Certainly, if ever there was a question of law fairly open to discussion and fairly the subject matter of compromise, this was such a question.

### III.

**The evidence shows that the compromise agreement was not made in bad faith, but, on the contrary, the evidence overwhelmingly shows that the compromise agreement was entered into in good faith.**

The complaint in this case bristles with charges of fraud. It is true that the ugly word fraud is not itself used throughout the complaint, but allegations of fact are made with regard to the pecuniary interests and the motives of the directors of the Harlem Company which, if true, conclusively establish the most corrupt and fraudulent conduct on their part.

It is averred that the "financial" interests of the majority of the common directors of the two companies were much larger in the Central Company than they were in the Harlem. It is averred also that such majority "owned or controlled a majority of the stock of both companies and dominated the policy and controlled the management of each company and the selection of officers and directors thereof." It is averred also that certain of the directors of the Harlem Company and certain "favored stockholders" of the Harlem Company were interested in the profits to be derived from the sale of the refunding bonds of the Harlem Company and the Central Company, and in the profits of a certain syndicate formed by J. P. Morgan & Company for the sale of such bonds, which bonds were sold to J. P. Morgan & Co. at a price "millions of dollars less than the fair market value thereof." It is stated, either directly or inferentially, by the complaint, that the votes of the Harlem directors and of the Harlem stockholders, in favor of the compromise agreement, were influenced by the interest of the directors and of such favored stockholders, first, in the Central Railroad, and, secondly, in the Morgan Syndicate and in the profits on the sale of the refunding bonds.

Each and all of these allegations not only fail of

proof, but are affirmatively disproved by the stipulated facts in the stipulation signed by the attorney for the plaintiffs, months before this action came to trial and months prior to the argument upon the motion to dismiss the complaint at the opening of the plaintiffs' case. Every allegation of the complaint except those expressly admitted by the answers, has been affirmatively disproved by the stipulated facts in this case, and by the testimony adduced on behalf of the plaintiffs.

(a) It is *not true* that the common directors or a majority of the directors of the Harlem Company, were more largely interested in the Central Company than they were in the Harlem Company.

(b) It is *not true* that the majority of the directors "owned or controlled a majority of the stock of both companies" or "dominated" or "controlled" either company, or selected the officers and directors thereof.

(c) It is *not true* that the second supplementary contract was authorized by votes of certain of the directors of the Harlem Company who were interested in the contract for the purchase of the refunding bonds of the Harlem Company.

(d) It is *not true* that the resolutions adopted by the stockholders, in favor of the compromise agreement, in October, 1898, were adopted by the vote of stockholders interested in the Central Company, or interested in the J. P. Morgan & Company Syndicate, or in the profits of the refunding bonds.

(e) It is *not true*, as alleged in the complaint, that the suit brought by the Central Company against the Harlem Company, was brought in bad faith, or as a pretext and basis for a subsequent compromise between the parties.

(f) It is *not true*, as alleged in the complaint, that the refunding bonds of the Central Company were sold to J. P. Morgan & Company and to J. S. Morgan & Company at a price which was "millions of dollars less than the fair market value thereof"; or that the refunding bonds of the Harlem Company were sold to said firms at a price "very much below their then market value."

(g) The indemnity agreement and the settlement of the Hitchcock suit are in no respect evidence of bad faith, and do not even tend to supply the total failure of plaintiffs' affirmative proof of bad faith.

(a) It is averred in the complaint and the allegation is several times referred to in the opinion of the Referee on the motion to dismiss, that "the financial interests" of the common directors of the Harlem Company, and of the Central Company were "much larger" in the Central Company than in the Harlem Company (see Complaint, fol. 35). The proof, however, shows that so far as concerns any question at issue in this action the exact contrary is the fact.

Even as to William K. Vanderbilt, who is more particularly singled out as the target of attack by the plaintiffs, the facts show that his interests in the Harlem Railroad were proportionately greater than his interests in the Central, *so far as concerned the effect of the compromise*, and that while nominally he owned a larger amount of stock in the Central than he did in the Harlem, yet, in view of the proportion of the stock which he held in the Central to the total stock of that company, as compared with the proportion of the stock which he held in the Harlem to the total stock of that company, he was a loser by the compromise agreement (upon plaintiff's theory of the rights of the Harlem stockholders) to the extent of several thousand dollars per year.

As to Cornelius Vanderbilt, who was the president of the company, who signed the circular to the stockholders, and who participated as a director in the meeting in November, 1898, at which he reported the proceedings taken at the stockholders meeting, the evidence shows that in every way his interest in the Harlem was many times that of his interest in the Central.

Of the other common directors only one (Mr. F. W. Vanderbilt) was a gainer by the compromise agreement and he was a gainer to the insignificant amount of \$440 per year.

The following schedule shows the exact figures, as of April 14, 1897, and as of June 28, 1898.

## Schedule exhibiting the effect of the Compromise upon certain personal interests.

By the Compromise Agreement the Harlem Company conceded to the Central Company \$220,000 per annum, which, upon the theory of the complaint, was a loss to each Harlem share and a gain to each Central share. Thus considered :

Each of the 200,000 Harlem shares lost \$1.10 per annum.

Each of the 1,000,000 Central shares gained \$.22 per annum.

### I. On April 14, 1897.

	Harlem Loss.		Central Gain.		Harlem-Central.
	Shares	Loss @ \$1.10.	Shares	Gain @ \$.22.	
Common Directors :					Net Annual Loss.
C. Vanderbilt	39668	\$43,634.60	10,000	\$2,200.00	\$41,434.80
W. K. Vanderbilt	12718	13,989.80	12,000	2,640.00	11,349.80
F. W. Vanderbilt	100	110.00	1,100	242.00	(132.00)*
S. F. Barger	100	110.00	200	44.00	66.00
C. M. Depew	200	220.00	11	2.42	217.58
C. C. Clarke	100	110.00	112	24.64	85.36
S. D. Babcock	—	—	100	22.00	(22.00)*
Persons not Common Directors :					
Ex'rs W. H. Vanderbilt	4460	4,906.00	—	—	4,906.00
J. P. Morgan	6125	6,737.50	550	121.00	6,616.50
J. P. Morgan & Co.	—	—	10,600	2,332.00	(2,332.00)*
Mutual Life Ins. Co.	9085	9,993.50	—	—	9,993.50

II. On June 28, 1898.

	Harlem Loss.		Central Gain.		Harlem-Central.
	Shares †	Loss @ \$1.10	Shares †	Gain @ \$.22.	
Common Directors					Net Annual Loss.
C. Vanderbilt	39,668	\$43,634.60	15,500	\$3,410.00	\$40,224.80
W. K. Vanderbilt	18,718	20,589.80	48,000	10,560.00	10,029.80
F. W. Vanderbilt.	100	110.00	2,500	550.00	(440.00)*
S. F. Barger	100	110.00	200	44.00	66.00
C. M. Depew	200	220.00	11	2.42	217.58
C. C. Clarke	100	110.00	112	24.64	85.36
S. D. Babcock	50	55.00	100	22.00	33.00
Persons not Common Directors					
Ex'rs W. H. Vanderbilt	4,460	4,906.00	—	—	4,906.00
J. P. Morgan	6,125	6,737.50	550	121.00	6,616.50
J. P. Morgan & Co.	—	—	100	22.00	(22.00)*
Mutual Life Ins. Co.	9,085	9,993.50	5,000	1,100.00	8,893.50

\* Gain.

† As appears by Defendants' Exhibit A, December 29, 1903.

By the figures in evidence summarized in the foregoing schedule it appears that on June 28, 1898, the Harlem Railroad had outstanding 200,000 shares of \$50 each, while the Central had outstanding 1,000,000 shares of \$100 each.

It is alleged that upon the compromise, the Harlem Company conceded \$220,000 per annum to the Central. Apportioning this sum among the the shares of the respective companies, the result would be that each Harlem share loses \$1.10 per annum, while each Central share gains only 22 cents per annum. It appears, further, that Mr. William K. Vanderbilt at that time owned 18,718 shares of Harlem, and 48,000 shares of Central. He lost on his Harlem stock, at \$1.10 per share, \$20,589.80 per year, while he gained on his Central stock, \$10,560 per year—leaving a net loss of \$10,029.80 per annum.

It appears, further, that Mr. Cornelius Vanderbilt held 39,668 shares of Harlem stock and only 15,500 shares of Central stock. His loss on the Harlem stock, at \$1.10 per share, was \$43,634.60 per annum, while his gain on the Central stock, was \$3,410, making a net loss to Mr. Cornelius Vanderbilt, per annum, by the outrageous frauds which he is said to have perpetrated or assisted in perpetrating, of \$40,224.80 per annum.

The only person who seems to have gained by this transaction was Mr. F. W. Vanderbilt, whose loss on his Harlem stock, 100 shares at \$1.10, was \$110, while his gain on his Central stock, 2,500 shares at 22 cents a share, was \$550, making a net gain to Mr. F. W. Vanderbilt (by this alleged fraud) of \$440 per year.

Even the plaintiffs have not ventured to suggest that Mr. Frederick W. Vanderbilt conspired with himself to gain the munificent sum of \$440 a year, and to defraud his two brothers out of \$50,000 a year.

The other common directors of the Harlem and Central Companies had comparatively small holdings in either company. As a matter of fact, their holdings on June 28, 1898, were as follows :

Mr. S. D. Babcock held 50 shares of Harlem and 100 shares of Central, on which he lost, by the compromise agreement, \$55 a year and gained \$22 a year, leaving a net loss of \$33 a year.

Mr. S. F. Barger owned 100 shares of Harlem and 200 shares of Central, making his loss, by the compromise agreement, \$110 per annum, and his gain, by the compromise agreement, \$44, a net loss of \$66.

Mr. Chauncey M. Depew had 200 shares of Harlem and only 11 shares of Central. His loss on the Harlem shares was \$220 a year; his gain on the Central \$2.42, making a net loss of \$217.58.

Mr. C. C. Clarke had 100 shares of Harlem and 112 shares of Central. His loss on the Harlem shares was \$110 per annum; his gain on the Central shares \$24.64 per annum, leaving a net loss of \$85.36.

So much for the allegation of the complaint that the "pecuniary interests of the common directors as stockholders in the Central Company were much larger in that company than in the Harlem Company," and were promoted by relieving the Central Company of its full obligation under the Sixth Article of the lease. So far is this from being true that so far as concerns any question at issue in this action, it is grotesquely and absurdly false. If ever there was a case where the directors of a corporation appear to have acted from conscientious motives and with a view to the interests of their stockholders, rather than with a view to their own pecuniary interests, this is such a case.

For purposes of convenience, the holdings of stock have been taken as of April 14, 1897, and June 28 1898. There is no point of time, however, which can be taken which will not show substantially the same results. The allegation of the complaint, at folio 35, paragraph thirteenth—

"the financial interests of said controlling and  
"managing directors have been during said period

“ and now are, much larger in the Central Company than in the Harlem Company ”—

therefore, not only is not proved, but is actually disproved by the facts conceded in this case and put in evidence by the plaintiffs themselves.

(b) It is averred in the complaint that : “ Prior to the year 1896 and continuously since the year 1896, a majority of the Board of Directors of the Central Company also constituted a majority of the Board of Directors of the Harlem Company and such majority *owned or controlled a majority of the stock* of both companies and *dominated the policy and controlled the management* of each company *and the selections of officers and directors thereof*” (Complaint, Par. XIII., fols. 34, 35).

The Referee, in his written opinion on the motion to dismiss upon the complaint, lays great stress on this (supposedly true) allegation and says :

“ In view of the allegation that the majority of the common directors owned a majority of the stock of each corporation, and dominated and controlled the action of both, and selected the officers and directors of each, it is a reasonable inference that the contract was, in substance, a contract dictated by, if not formally made between, the common directors of the two corporations.”

This allegation, like all of the other substantial allegations of the complaint, is wholly unsupported by the proof. The contrary is affirmatively proved. The common directors did not own a majority of the stock of either corporation, nor did they dominate or control the action of either, or select the officers and directors of either.

The fact that some of them acted as proxies at the meetings of stockholders falls very far short of any proof of these allegations. No stockholder was under

any legal or moral obligation to give a proxy to Mr. William K. Vanderbilt or Mr. Cornelius Vanderbilt, or any other member of the board. Every stockholder was at liberty to attend any meeting of the stockholders and vote in person, or to select any proxy he chose. The usual custom was pursued, which prevails in all corporations, so far as we have any knowledge of them, viz., to send out printed proxies for the signature of the stockholders, together with the notice of the stockholders' meeting. The custom is for those who are in favor of retaining in office the then existing board and the then-existing officers, to sign these proxies. If, for any reason, they are dissatisfied, they are at liberty to combine and select other proxies, or to act as individuals, by proxy or personally, as they may choose.

It does not follow because Mr. Cornelius Vanderbilt and Mr. William K. Vanderbilt and others of the Board of Directors of the two companies acted as proxies, that they therefore "dominated and controlled the action" or "selected the officers and directors" of either company. They could only select the officers and directors by the voluntary act of the stockholders in signing the proxies. These stockholders were persons of independent standing and judgment, and were abundantly able to decide whether or not they wished to give their proxies to these gentlemen.

At the time of the special meeting on October 5, 1898, of the stockholders of the Harlem Company called to pass upon the compromise agreement, Mr. Cornelius Vanderbilt owned only 39,648 shares out of the 200,000 outstanding; Mr. William K. Vanderbilt owned only 18,718, and Mr. Frederick W. Vanderbilt 100, making a total owned by the three Vanderbilts of only 58,466, or a little over one-quarter. The estate of William H. Vanderbilt owned 4,460; J. P. Morgan, 6,125. Adding these to the Vanderbilt holdings, we have only 69,051, or a little over one-third of the total stock. No other director held more than 100 shares, except Mr. Depew, who held 200, and Mr. Van Santvoord, who owned 126. Adding in all their holdings, we have 69,827 out of the

total 200,000, as against over 130,000 held by other stockholders. So much for the alleged "domination" by the common directors.

There is, therefore, we repeat, no proof of the allegation which the Referee, in his opinion, commented upon as important, that the majority of the common directors owned a majority of the stock of each corporation, or dominated or controlled the action of both, or selected the officers and directors of each. The proof is directly to the contrary. There is, consequently, no basis for the inference which the Referee held to be a reasonable inference from these allegations :

" that the contract was, in substance, a contract  
" dictated by, if not formally made between, the  
" common directors of the two corporations."

(c) It is averred in the complaint that the second supplementary contract was authorized and approved "*by votes of certain of the Directors of the Harlem Company who were interested in the contract for the purchase of the bonds of the Harlem Company mentioned in said supplementary contract, and who were also interested in the purchase of the bonds of the Central Company hereinafter mentioned*" (Complaint, Par. XVI., fol. 46).

A more wanton and reckless misstatement of fact it would be difficult to conceive.

It is stipulated as a fact in this case (Article 39, p. 32) that "*no other director* [except J. P. Morgan] of the Central Company or of the Harlem Company *was a subscriber to the said syndicate agreement*. It is further admitted that Mr. Morgan was not a director of the Harlem Company until the 15th of May, 1900, after every act complained of in this action had been done and performed (Article 30, p. 21).

No attempt has been made by plaintiffs to establish this serious charge, involving, as it does, gross moral

turpitude, except as to William K. Vanderbilt and the attempt as to him has signally failed.

It is stipulated as a fact in the case, by Article 40, that Mr. William K. Vanderbilt, by a letter dated the 13th day of April, 1897, offered to take \$1,000,000 of the new Harlem bonds at 101, and \$5,000,000 of the new Central bonds at par—which offer, on April 14th, 1897, was accepted by J. P. Morgan & Company by a letter; and Mr. Vanderbilt caused to be purchased by the trustees under the will of his late father, William H. Vanderbilt, from J. P. Morgan & Company, the \$1,000,000 of said new Harlem bonds, which he had agreed to take, by his letter of the 13th of April, 1897.

These bonds were bought for a trust investment, not for resale. If still held by the trust, as presumptively they are, the evidence shows that to-day they are worth not more than 101, exactly what was paid for them.

It is further stipulated by Article 40 as follows :

“ He is not personally interested in said bonds  
 “ except as a beneficiary for life of the said estate  
 “ for which said bonds were purchased; and his  
 “ only interest in the trust estate is to receive the  
 “ income thereof during his life.”

Even assuming, however, that Mr. W. K. Vanderbilt personally would have obtained any profit from the Harlem bond sale, he could not have been actuated by any desire to secure such a profit, for in any contingency and whatever the rate of profit received by the Syndicate on the sale of the bonds his proportionate share of any loss suffered by the Harlem with respect to the bond sale would have been correspondingly greater than any possible gain he could have made upon such sale. This is susceptible of mathematical demonstration, as follows :

## I.

Mr. W. K. Vanderbilt's alleged bond interest was in only \$1,000,000. out of the total of \$12,000,000. For this \$1,000,000. he paid 101, whereas the Syndicate Managers received them at 100. Thus it appears that

Mr. Vanderbilt, as holder of 18,718 Harlem shares, lost $\frac{18718}{20000000}$ of any sum of which Harlem was defrauded in its bond sale or-----	9.3%
Mr. Vanderbilt, as recipient of less than one-twelfth of the excessive profit, whatever its amount, would have gained not more than $\frac{1}{12}$ or less than-----	8.3%
Resulting in a net loss to Mr. Vanderbilt exceeding-----	1%

## II.

The condition may be illustrated in concrete figures :

If the bonds were really worth  $115\frac{7}{8}$ , (the highest price at which any were ever sold), the Harlem Company by selling at par lost  $15\frac{7}{8}\%$  on \$12,000,000 which would be \$1,905,000 or \$9.53 per share. Therefore,

As a Harlem stockholder Mr. Vanderbilt lost	
\$9.53 upon 18718 shares or-----	\$178,382.54
By the imagined purchase he gained ( $115\frac{7}{8}$ -- 101) $14\frac{7}{8}\%$ on \$1,000,000, or-----	148,750.00
Net loss-----	\$29,632.54

Whatever figure be taken for the bonds the result must be always to Mr. Vanderbilt's pecuniary disadvantage, because as a Harlem stockholder his interest was ratably larger than his interest as a purchaser of Harlem Bonds.

(d) It is not directly charged in the complaint, but it is insinuated that in their adoption of the compromise agreement the stockholders of the Harlem Company were influenced by their interest in the Central Co., and by their interest in the contract for the sale of the bonds.

It is averred that a majority of the stock of both companies was owned or controlled by the common directors of the two companies, and it is stated to be a "fact" that "certain favored stockholders of the Harlem Company and certain of its directors were interested in the contract for the sale of said bonds mentioned and referred to in said second supplementary contract" (Complaint, fols. 35, 43).

We have already shown that a majority of the stock of the Harlem Company was neither owned nor controlled by the directors of the Harlem Company. The plaintiffs have failed to show that directors of that company were interested, to the extent of one dollar in the contract for the sale of the Harlem or the Central refunding bonds; and it is expressly stipulated (Article 39) that no Harlem Director nor (excepting J. P. Morgan) any Central Director was a subscriber to the syndicate agreement.

It remains to consider only the charge as to the so-called "favored stockholders" of the Harlem Co. Upon investigation this charge turns out to be as absolutely baseless as all the other charges against the good faith of the stockholders and directors.

There are three lines along which the plaintiffs urge their suggestions that the majority of the stockholders may have had interests adverse to the minority in respect to the compromise agreement, viz. :

1. That certain stockholders of the Harlem Company were subscribers to the syndicate agreement and that certain other stockholders were trustees or di-

rectors of certain corporations, or were members of certain firms who were subscribers to the syndicate. (Article 39.)

2. That common directors of the two Companies were incompetent to vote at a stockholders' meeting.

3. That certain stockholders of the Harlem had a greater interest in the Central than in the Harlem

It appears, however, from the following Schedule, that if all the shares so alleged to have been incompetent be excluded, *there still remain in favor of the compromise a clear majority of all unimpeached shares whether voting or not voting.*

## Schedule Exhibiting Alleged Personal Interest of Harlem Stockholders in the Compromise Agreement.

1. *Shares alleged to have been affected by the bond transaction. (Article 39 and Schedule 26.)*

W. K. Vanderbilt.....	18,718
J. P. Morgan.....	6,125
Mutual Life Ins. Co.....	9,085
U. S. Trust Co. as trustee.....	1,050
Union Trust Co. as trustee.....	1,000
Strong, Sturges & Co.....	18
Morristown Trust Co.....	93
Charles Lanier.....	200
Samuel D. Babcock.....	50
Charles S. Smith.....	100
William D. Sloane.....	100
C. M. Depew, individually.....	200
C. M. Depew, as trustee.....	560
Samuel F. Barger.....	100
F. W. Vanderbilt, individually.....	100
F. W. Vanderbilt, as Ex'r.....	4,460
S. Thorne, individually.....	400
S. Thorne, as trustee.....	1,000
	43,359

2. *Shares held by common directors not included above :*

C. Vanderbilt.....	39,668
C. C. Clark.....	100
	39,768

3. *Shares voted by other persons, having greater interest in Central than in Harlem (Schedule 27) : \**

J. T. Agnew.....	82
A. Brown.....	55
W. H. Doughty.....	20
A. P. Gardner.....	38
G. N. Howe.....	5
B. F. Isherwood.....	497
E. C. Kidd.....	5
S. M. Krumbhaar.....	5
S. N. Lansing.....	5
J. C. Nott.....	5
C. C. Pruyn.....	5
A. A. Raven.....	10
C. S. Ransom.....	5
F. M. Taylor.....	10
C. A. Van Duesen.....	53
F. H. Vall.....	20
Webb & Prall.....	150
	907

Total alleged incompetent shares ..... 84,097

\* Total number of Harlem shares was..... 200,000  
 Total number of Central shares was..... 1,000,000  
 The plaintiffs assert that under the compromise, the Harlem Company conceded to the Central Company \$220,000 per annum.  
 Thus each Harlem share would have lost \$1.10.

Each Central share would have gained 22c.

Therefore, only those stockholders, who held *more than five shares* of Central to one share of Harlem can be charged with an interest adverse to the Harlem in the matter of the compromise.

The total number of Harlem shares was---	200,000.
Shares alleged to be incompetent-----	84,097.

Shares unchallenged -----	116,903.
Of which a majority would be--	<b>58,452.</b>

The total vote in favor of the compromise was (Schedule 25) -----	146,519.
Deduct the alleged incompetent vote-----	84,097.

And there remains in favor of compromise an unchallenged vote of-----	<b>62,422.</b>
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or about 4,000 shares more than a majority of all the stock not now challenged.

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Incidentally, it may be of interest to observe that the actual objectors to the compromise number 23 and the alleged disqualified voters number only 37, making a total of **60** out of the grand total of **770** Harlem stockholders, of whom (Article 38) **747** (or more than **97%**) holding **188,347** shares (or more than **94%**), of the total capital stock have accepted the compromise and have accepted and retained payments thereunder.

Further comment on this branch of the case would seem to be superfluous. The figures speak for themselves.

(e) It is averred in the complaint that the suit brought by the Central Company against the Harlem Company was "not instituted in good faith, or for the purpose or with the intent of prosecuting the same to judgment, and was only commenced for the purpose of discontinuing the same and thereby furnishing a colorable excuse or pretended consideration for the said so-called compromise and second supplementary contract" (Complaint, Par. XV., fol. 45).

The evidence conclusively disproves this allegation.

On May 18, 1897, the directors of the Central Company passed resolutions reciting that the company had been "advised" that the claim of the Harlem Company "is not justified by the terms of said contract and is in the highest degree unjust" (p. 118), and instructing the general counsel of the company "immediately to retain and associate with him Ashbel Green and Edward J. Phelps for the purpose of beginning and prosecuting such action or actions and legal proceeding or legal proceedings as may be necessary to secure and protect the rights of the Central Company in the premises" (pp. 119, 120).

The legal opinion of Messrs. Phelps, Loomis & Green had been given to Mr. Depew, the president of the Central Company, in his official capacity, on the previous day, and was unqualifiedly and emphatically opposed to the claim of the Harlem Company. That opinion makes no suggestion of any possible compromise, but does advise asserting the rights of the Central Company, "by appropriate action or legal proceedings," and submits the resolutions to be adopted by the directors at their meeting on the 18th (pp. 53, 54).

Mr. H. McK. Twombly, who introduced the resolutions and moved their adoption in the Central board, was called as a witness for the plaintiffs and testified unequivocally to the good faith with which the resolutions were introduced and passed. There is no evidence to the contrary.

That the proposed litigation was to be a genuine one and was not a mere cover or pretext for compromise is further shown by the fact that copies of the resolutions were directed to be served on the chairman or presiding officer of the meeting of the stockholders of the Harlem Company to be held that day, May 18th, 1897, together with copies of the request and protest of the Central Co. addressed to the Harlem Company (pp. 120, 121).

Not only so, but it was resolved further that a copy of the proceedings of the meeting "be presented and read to the meeting of the stockholders of this company (*i. e.*, the Central Company) called to be held at

the City of Albany on the 26th day of May, 1897, and that the stockholders present and represented at said meeting be requested to approve the action of the board in the premises," and it was further

" *Resolved*, That printed copies of the proceedings of this meeting be immediately served, personally or by mail, upon each stockholder of this Company " (p. 120).

Directors who contemplated a fake suit would hardly have caused the full proceedings to be communicated to the impending meetings of the stockholders of both companies—to the Harlem stockholders as the earliest possible warning of the Central claim; and to the Central stockholders as an announcement of the intention to maintain the Central interests and for approval thereof. When these resolutions were adopted by the Central Board it was not known but that many stockholders of both companies would attend the meeting. In any aspect this publication at the very first meeting to be held by the stockholders of each company was significant of the utmost good faith.

From the minutes of the stockholders' meeting of the Central Company, held May 26th, 1897 (Supplemental Stipulation as to Facts, Schedule 36a, pp. 2 to 11), it appears that there were present or represented at that meeting 710,692 shares out of the total capital of 1,000,000 shares; and that the meeting unanimously approved the action of the board of directors taken at the meeting of April 14th, 1897. It further appears that "the secretary then presented and read to the meeting an attested copy of the proceedings of the board of directors of this company, held at the offices of the company at the Grand Central Depot, at the City of New York, May 18th, 1897. Upon motion of Mr. Hamilton Harris, it was unanimously *Resolved*, that the stockholders present and represented at this meeting do hereby approve the action of the board of directors at its meeting on May 18th, 1897, as now submitted to this meeting " (p. 9).

The Board of Directors of the Central Company met the next day, May 27th, 1897 (see Minutes of Meeting, Schedule 37a, Supplemental Stip., pp. 12 to 16), at which the proceedings of the stockholders' meeting were submitted. The president also submitted certain resolutions that day adopted by the Harlem Company, asserting its claims, and thereupon, on motion of Mr. Twombly, it was

*“ Resolved, that the President of this Company, any Vice-President, the Secretary or Treasurer, or any Director, be, and hereby he is, authorized, for and in the name of this Company, to sign and execute any agreement or submission to arbitration at common law or under the statutes of the State of New York, any submission to the Appellate Division of the Supreme Court, First Department, State of New York, or to verify any complaint, which may be submitted by the General Counsel of this Company, Ashbel Green and Edward J. Phelps, retained by this Company under the resolution adopted by the Board of Directors of this Company, May 18th, 1897, for the purpose of taking action to secure and protect the rights of this Company under the agreement between it and The New York and Harlem Railroad Company dated April 1st, 1873, or which may be submitted by other counsel retained by this Company in this behalf ”* (p. 14).

The resolutions adopted by the Harlem Company at their meeting on May 27th, 1897, appear in schedule 10 (pp. 149 to 152), and conclude with the following :

*“ Resolved, that the officers of this company be, and hereby they are, authorized and directed to retain counsel, and, in conformity to the advice of counsel so retained, in every proper way to proceed, either by arbitration, submission or otherwise, to obtain and to expedite the prompt and proper construction and determination of all the*

rights of this Company under the lease of April 1, 1873, and to assert and protect the rights of this Company under that lease" (p. 152).

In pursuance of these resolutions, Messrs. Francis Lynde Stetson and Joseph H. Choate were retained as counsel for the Harlem Company, and the suit of the Central Company against the Harlem Company was thereafter commenced and defended.

What is there in all this to even suggest bad faith or collusion ?

Counsel for the plaintiffs place much stress upon the fact that certain of the common directors of the two companies concurred in the adoption of resolutions of the Harlem Company asserting its rights, while, contemporaneously therewith, or substantially so, they concurred in resolutions of the Central Company also asserting its rights, diametrically opposite to those of the Harlem Company.

The argument of counsel on the other side would seem to be that the directors of the Harlem Company who voted in favor of the resolutions in the Harlem Board could not have voted in good faith for the resolutions passed in the Central Board. This, however, is a grossly unwarranted argument. If it be true that the Harlem Company was advised by its counsel, or by any reputable counsel, that it had a right to refund the Consolidated Mortgage, and thereafter to receive from the Central Railroad therefor the equivalent of the interest saved thereby, certainly it was the duty of the Harlem directors to assert such claim until the claim could be passed upon by a competent tribunal, or be adjusted by a fair compromise agreement. If, on the other hand, the directors of the Central Company were advised by their counsel, or by other reputable counsel, as they were most emphatically advised by Messrs. Phelps, Loomis and Green, that it was the right of the Central Company to require the Harlem Company to refund the bonds, and that the benefit of the refunding at a reduced rate of interest would enure to the Central Company, and

not to the Harlem, certainly it was the duty of the Central directors to take action in accordance with such opinion, and to insist upon such rights.

That some of the common directors of the two companies were present at the meetings of the two boards at which resolutions were adopted, and concurred therein, does not, in any way, impeach the good faith of the action taken by either of the two boards.

At the meeting of the Board of Directors of the Central Company held on the 18th of May, 1897, at which were adopted the preamble and resolutions asserting the rights of the Central Company, there were present ten directors. Of these ten directors, only three had participated in the meeting of the Harlem Board and voted for the resolutions adopted by that Board, at its meeting of April 14, 1897, viz., Mr. William K. Vanderbilt, Mr. Chauncey M. Depew and Mr. Frederick W. Vanderbilt (see fols. 43 and 44).

There is a total absence of any proof whatever, or any scintilla of proof, from which the Court can infer that the Board of Directors of each company was not acting in perfectly good faith and in the interests of their respective stockholders. Every intendment and presumption is in their favor (see, *Guidet vs. N. Y., L. E. & W. R. R. Co.*, 9 N. Y. St. Rep., 26 ; 120 N. Y., 649 ; *People vs. Kelly*, 11 App. Div., 495-500).

(f) The refunding bonds were not sold to J. P. Morgan & Co. and J. S. Morgan & Co. below their market value.

Great stress is laid in the complaint upon the contracts for the sale of the refunding bonds of the Harlem Company and the Central Company.

It is charged that certain of the directors and certain "favored stockholders" of the Harlem Company were interested in the profits of the Morgan & Co. Syndicate. We have already shown that this charge is absolutely untrue, so far as the directors are concerned, and substantially untrue so far as the stockholders are concerned.

Even if the charge were true, however, it would be of no significance in this suit, since this is not a suit for an accounting against the directors of the Harlem Company, nor is it a suit against the members of the Morgan firms to disaffirm the Morgan contracts.

No connection whatever has been shown between the making of the Morgan contracts and the making of the Second Supplementary Contract.

Assuming, however, for the purposes of the argument, that there is some relevancy to the charge that the bonds were sold at far below their market value, the question recurs :

Is there any proof to support the allegation that the contract with Mr. Morgan's firms was unfair? Absolutely none. It is stipulated (Article 41) that a syndicate was formed, of which J. P. Morgan & Company were members, and that in July, 1898, more than a year after the contract of purchase from the Harlem Company, this syndicate contracted to sell and deliver to Harvey Fisk & Sons, as managers of another syndicate, \$11,000,000 of the said bonds of the Harlem Company, at the price of 108½. It was proved (Banks, page 24) that the sale was of bonds deliverable not presently but "when they were to be issued," and (pp. 24, 25) that none were issued or received until in or after May, 1900, as indeed is alleged in the Complaint (folio 49), and stated by Mr. Trull (page 18) and proved by Mr. Banks (pp. 24, 25).

It appears further that at various dates in 1899 and 1900, Harvey Fisk & Sons sold \$4,475,000 of these bonds; \$1,955,000 of these bonds were sold as high as 115 and a fraction. More than half of the bonds actually sold—\$2,500,000 out of \$4,475,000—however, were sold as low as 112½ (pp. 23, 24). The residue of the \$11,000,000 of bonds not sold by Harvey Fisk & Sons (namely, \$6,525,000) were withdrawn by the Fisk Syndicate subscribers at 108½ (see testimony of Mr. Banks, p. 25).

This testimony of Mr. Banks absolutely demolishes the extraordinary and reckless allegation of the complaint, verified in June, 1900, "that the Second Syndi-

"cate have sold said bonds at a premium of upwards of fifteen per cent., thus making a profit on the bonds by way of premium over the price obtained by the Harlem Company—the sum of \$11,800,000."

Assuming, however, that the market value of the bonds in 1899 and 1900 was 115 or 112½, and after June, 1898, was 108½, it by no means follows that in the spring of 1897, when the contract with Mr. Morgan's firms was made, the Directors of the Harlem Company made an unwise or an unfair bargain or contract with Mr. Morgan's firms. There is no proof made or offered by the plaintiffs to the effect that in April, 1897, an entire issue of \$12,000,000 of 3½ per cent. bonds could have been floated as an entirety or peddled in small lots at more than par. No witness has been called by the plaintiffs to testify that in the spring of 1897 anybody would have given more than par for the refunding bonds of the Harlem Railroad or bonds of any other railroad bearing only 3½ per cent interest.

Mr. Banks, of the firm of Harvey Fisk & Sons, was called by the plaintiffs as a witness and placed upon the stand. It appeared that he is an expert on the value of railroad bonds, and that his firm has been and is one of the largest firms dealing in bonds in the United States. No question was asked of Mr. Banks for the purpose of showing that the price at which these bonds were sold by the Harlem Company to J. P. Morgan & Company and J. S. Morgan & Company was unfair, or that any other firm or any other individuals would have given more for these bonds, in the spring of 1897, than was given by the purchasers.

Nor is there any proof that any of the stockholders of the Harlem Company would have given more than par for the bonds had they been offered to the stockholders for sale.

It appeared further (Banks, p. 31) that no 3½ per cent. bonds other than those of the Illinois Central Railroad which sold at about par, and those of the Lake Shore and Michigan Southern Railway which sold at 99 per cent. had been issued by any railroad prior to the date of the Morgan contract.

Mr. Twombly, called as a witness for the plaintiffs, testified to the effect that the bonds were sold to the Morgan firms at their fair market value. He testified also to his own experience in the winter of 1896 and 1897 as a director of the Lake Shore and Michigan Southern Railroad in negotiating the  $3\frac{1}{2}$  per cent. bonds of that company, which he testified *are as good as any in the United States*. They were negotiated at par less one per cent. He testifies: "I had sold those to Speyer & Co. and we were all very much satisfied, and a great many people were surprised that we could have sold those bonds at that price at that time."

It appears further, from the testimony of Mr. Banks and of Mr. Twombly, that at its session in 1898 the Legislature passed a law authorizing savings banks to invest in this character of bonds, and this legislation resulted in creating a demand for such securities and enhanced their market value. It further appears, from the testimony of Mr. Banks, that the market price of the Harlem bonds has fluctuated very considerably, as has the price of other bonds in the market. Mr. Banks testified that at the time he testified (November 18, 1903), the price of the Harlem bonds in the market was "about par," the witness knowing of actual sales at that price.

The law referred to by Mr. Banks, giving the right to savings banks to invest in this character of bonds, is Chapter 236 of the Laws of 1898, passed April 14, 1898, or thereabouts (Mr. Banks' Testimony, at p. 30). The savings banks of the State have taken and held upwards of two millions of dollars of these Harlem bonds under this law (page 32 of Mr. Banks' Testimony). The price of bonds and stocks generally was very much lower in May, 1897, than afterward existed. "There were a great many bonds that were lower at that time than they are at the present time." As to railroad bonds generally in the winter and spring of 1896-97, the prices were as low, if not lower, at that time than at the present time (pp. 32, 33).

As these Harlem bonds are now selling in the market at about par, and as the prices in 1896-97 were as low as, if not lower than, present prices prevailing in the market, it is quite evident that the price at which these bonds were sold to J. P. Morgan & Company and J. S. Morgan & Company was not below their then market value, and this irrespective of the uncertainties attending the possible negotiation at any fair price of railroad bonds bearing only three and one-half per cent. which was a new experiment, there having been only one issue of railroad bonds bearing interest as low as three and one-half per cent. in this country, prior to May, 1897, viz., bonds of the Illinois Central (see Mr. Banks' testimony at p. 31).

That the negotiation of three and one-half per cent. bonds at par was by no means a certainty, and that in entering into these contracts with the Harlem Company and the Central Company the Morgan firms took some risk is apparent also from the written opinion of Mr. Trull, given in December, 1896, to the Continental Insurance Company, in which he states that four per cent. refunding bonds could probably be sold at a premium of \$360,000; that is to say, at one hundred and three per cent. (see Mr. Trull's opinion, Schedule 2, p. 78):

“ Assuming that a new issue of bonds can be  
 “ made by the lessor company, bearing interest at  
 “ the rate of 4% per annum, it is believed that the  
 “ entire issue could be sold and disposed of upon  
 “ terms which would realize a premium upon the  
 “ total issue of \$360,000.”

Of course, if four per cent. bonds could be negotiated only at 103, it would follow that three and one-half per cent. bonds could not be negotiated at par.

It may be noted in this connection, as bearing upon the good judgment of the Harlem directors, as well as upon their good faith, that the scheme actually adopted by the Harlem directors for refunding the debt at three and one-half per cent. was vastly prefer-

able, in the interest of the stockholders, to that suggested by Mr. Trull. The issuing of four per cent. bonds, as Mr. Trull states, would have netted to the Harlem Company a premium of \$360,000. By issuing three and one-half per cent. bonds at par the company saved one-half per cent. per annum for 100 years, making a total interest saving during 100 years of \$60,000 per annum, or \$6,000,000 for the 100 years. Deducting from this Mr. Trull's estimated premium of \$360,000, we have a net saving of \$5,640,000 under the three and one-half per cent. plan as carried out by the directors, on the one hand, as compared with the plan proposed by Mr. Trull, on the other hand—an amount nearly equal to one-half of the total principal of the mortgage.

The allegation of the complaint charging that the directors wrongfully failed to give the stockholders an opportunity to bid for the bonds, is not supported by any evidence tending to show that any stockholder would have bid for the bonds. The elaborate discussion in Mr. Trull's opinion of the proposition that 7% Bonds might be issued to the stockholders at par, leads naturally to the inference that that is the rate at which stockholders would have taken the bonds.

There is, therefore, a total failure of proof to support the charge of unfairness in the price at which the bonds were sold to J. P. Morgan & Company and J. S. Morgan & Company on a  $3\frac{1}{2}\%$  basis. On the contrary, the fairness of that price at that time has been affirmatively established.

(g) The settlement of the Hitchcock suit and the agreement of indemnity on behalf of the Central Company do not in any respect tend to sustain the contention of the plaintiffs in this suit.

1. Even if any inference could fairly be drawn from these transactions (which we emphatically dispute) adverse to the good faith of the directors, as tending to show doubt on their part as to the legality or propriety of their previous conduct, such an inference

could not supply the place of substantial proof in any way impeaching the previous transactions resulting in the compromise agreement. If there were some affirmative evidence of bad faith or fraud, the unfavorable inference (if any) growing out of these two matters might, perhaps, avail plaintiffs as a make-weight, but in and of itself it cannot have any probative force, there being no affirmative evidence. Much less can it negative the evidence affirmatively establishing good faith prior to these two transactions.

2. The compromise agreement was a binding agreement when adopted by the stockholders of the two companies, and no subsequent action or failure to act on the part of the directors of either company can affect the rights or liabilities arising therefrom.

The Board of Directors of each company appointed a committee with full power to confer with a committee from the other company with regard to a compromise of the pending controversy between the two companies and to make a settlement.

The resolutions of the Central Board which were adopted on the 22d of June, 1898, recited that: "In the opinion of this Board, it is for the best interests of this company, and of the stockholders thereof, that the uncertainty of litigation should be avoided, and that the advantage of a certain diminution in the payments under such lease should be secured to this company by an amicable adjustment of the differences between the two companies." A committee was therefore, appointed, consisting of the president and Messrs. Morgan and Twombly, "with power to negotiate with the New York and Harlem Railroad Company for an adjustment of the matters in controversy between the last named company and this company, arising under the lease of April 1, 1873, and with power to make a settlement." It was further "*Resolved, That the President and Secretary of the Company be authorized and directed to execute, under the seal of the Company, such agreements as may be necessary to carry such settlement into effect, and if, in the opinion of counsel, such action*

*is necessary, to call a meeting of the stockholders of this company, at which such agreement shall be submitted for their consideration and action”* (pp. 215, 216).

At the meeting of the Harlem Directors held on the 28th of June, 1898, a copy of the resolutions of the Central Directors was received and it was thereupon Resolved, as follows :

“ WHEREAS, In the opinion of this Board, it is for the best interests of this Company and the stockholders thereof that the uncertainty of litigation should be avoided, and that the advantage of a certain increase in the rental under said Lease should be secured, by an amicable adjustment of the differences between the said two Companies.

“ NOW, THEREFORE, it is hereby

“ *Resolved*, That a Committee of this Board, consisting of Messrs. A. Van Santvoord, F. P. Freeman and J. B. Dutcher be, and hereby is, appointed to negotiate with the New York Central and Hudson River Railroad Company for the adjustment of the matters in controversy between that Company and this Company arising under the Lease of April 1st, 1873.

“ *Resolved*, That when and if the said Committee shall reach an agreement, it shall report the same to the meeting of the Stockholders of this Company, to be held as hereafter provided, and shall cause such report to be submitted for the action of the Stockholders of the Company at such meeting.

“ *Resolved*, That *when and as approved by the Stockholders of this Company at the said meeting and not otherwise, the report and agreement of the Committee shall be binding upon this Company and the Stockholders thereof, and that the President or Vice-President, and the Secretary, of this Company, be authorized and directed from time to time to execute, under the seal of the Company, such agreements as may be necessary fully to carry into effect*

*such settlement*, either in the course of the pending litigation and as part thereof, or in and after discontinuance of such litigation, or in such manner as to the said Committee shall seem best to secure and to effect complete and final adjustment and compromise of the claims and differences between these two Companies.

“*Resolved*, That a special meeting of the Stockholders of the New York and Harlem Railroad Company be, and hereby the same is, called to be held at the principal office of the Railroad Company, at New York, in the State of New York, at twelve o'clock noon, on Wednesday, the fifth day of October, 1898, for the purpose of submitting to the Stockholders *the final report* of a Committee appointed by the Board of Directors of this Company, to agree with the Board of Directors of the New York Central and Hudson River Railroad Company, upon a settlement of the questions between the two Companies, arising out of the Lease of April 1st, 1873, and the refunding of the Consolidated Mortgage bonds of this Company, and *for the purpose of taking final action with reference to such proposed settlement and agreement.*

“*Resolved*, That the Secretary of the Company be, and hereby he is, authorized and directed, in behalf of the Board of Directors, and in the manner required by law and by the by-laws of this Company, to give public notice of such meeting, such notice to be substantially of the form annexed to these minutes, and the date of such meeting to be inserted by him prior to the publication of such notice, *and immediately after the said Committee shall have agreed upon a settlement and report.*

“*Resolved*, That E. H. Goodwin and G. S. Prince and W. S. Crane be, and hereby they are, appointed Inspectors of Election, to hold the election of the Stockholders at the meeting this day called.”

The form of notice follows, precisely as subsequently sent out to the stockholders.

Nothing further remained to be done by the Directors, the whole matter being delegated by each Board to its committee with full power to make a settlement which *ipso facto* was to take effect when approved by the stockholders at their several meetings.

No further action was in fact taken by the Harlem Board on the subject till after the stockholders' meeting had been held and had adopted the compromise agreement.

The three members of the conference committee appointed by the Harlem Board were all of them holders of a substantial amount of stock of the Harlem Company, Mr. Van Santvoord holding 126 shares, worth (at the rate of 300%, see Article 14), \$18,900; Mr. Freeman and Mr. Dutcher 100 shares each, worth \$15,000. *No one of these three men was a director in the Central Company.* Mr. Van Santvoord did not own a single share of Central stock. Neither did Mr. Freeman (Article 20). Mr. Dutcher owned 100 shares of Central stock (Article 20); but as already pointed out, his pecuniary interests were very much greater, so far as the compromise affected those interests, on the Harlem side than on the Central side of the transaction. By the compromise agreement he gave up \$110 per annum as a Harlem stockholder while he gained only \$22 per annum as a Central stockholder.

This committee, therefore, was fully competent to represent the Harlem Company's interests and to act for that company.

The committees of the two boards met in joint conference on the 10th of August, 1898, and the following proceedings took place (see Schedule 17, pp. 224, 225):

“The Chairman then stated that the business before the meeting was the discussion, and, if practicable, the adjustment of the differences between the Central Company and the Harlem Company, in respect of the Lease of April 1, 1873. The Chairman presented the draft of a proposed

Second Supplementary Contract, which had been prepared as an amendment of the existing Lease, and which had been considered by some of the Stockholders of both Companies as affording a fair and acceptable basis of settlement. The main feature of which was the payment and reservation to the Harlem Stockholders of a sum equal to two per cent. upon their stock in addition to the rent already payable under the Lease of April 1, 1873, the Central Company to have the benefit or the burden of all decreases or increases in interest payments on any refunding of the bonds of the Harlem Company.

"Some discussion ensued, and, after various informal suggestions and an informal vote, it was generally agreed that the basis of settlement proposed was fair, and would be acceptable to the Stockholders of both Companies.

"Upon the motion of Mr. Morgan, seconded by Mr. Van Santvoord, and by the affirmative vote of all present, it was thereupon

*"Resolved, That the Committee of The New York Central and Hudson River Railroad Company, appointed under the resolutions of June 22, 1898, and the Committee of The New York and Harlem Railroad Company, appointed under the resolutions of June 28, 1898, having met in joint session this 10th day of August, 1898, do approve of an equitable and final adjustment of the differences between the two Companies concerning the provisions of the Contract of Lease dated April 1, 1873, by the execution, delivery and performance of a Second Supplementary Contract in the form of that now submitted to this meeting, of which a copy is annexed to the minutes hereof."*

The form annexed is the agreement as subsequently approved and adopted by the stockholders at their several meetings.

At a meeting of the Central Board held August 25th, 1898, the proceedings of the two committees' meeting

in joint conference were reported and approved, and a meeting of stockholders was directed to be called to consider and approve of the Second Supplementary Contract.

What took place was as follows (see Schedule 19, pp. 236, 237):

“The President reported that conference had been had between the Committee of this Board, appointed at a meeting held June 22d, 1898, and a Committee of the Board of Directors of the New York and Harlem Railroad Company, appointed at a meeting held June 28th, 1898, to consider the question of a compromise and adjustment of the controversy between the two companies arising under the contract of April 1st, 1873, which conference had resulted in the unanimous recommendation by the Joint Committees, of the *adoption of a Second Supplementary Contract.*

“The President presented the minutes of the meeting of the joint committee and the form of Second Supplementary Contract agreed upon, and *to bear date October 5th, 1898*, whereupon it was resolved that the *action of said joint committee be approved*, and that a copy of such minutes be spread upon the records of the minutes of this meeting.

“*Resolved*, That the Secretary be and he hereby is directed to call a meeting of the stockholders of this Company to be held at the office of the Company in the City of Albany on Wednesday, the 5th day of October, 1898, at 12 o'clock noon, to *consider and approve of the Second Supplementary Contract* between this Company and The New York and Harlem Railroad Company, and that the Secretary give proper notice by mail and by advertisement to the stockholders of this Company of such meeting.”

The notice sent out to the stockholders of the Harlem Company was as follows :

“Office of THE NEW YORK AND HARLEM RAIL- }  
ROAD COMPANY, }  
“ NEW YORK, September 1st, 1898. }

“ Notice is hereby given that a Special Meeting of the Stockholders of The New York and Harlem Railroad Company has been duly called, and will be held at the Company's principal office at New York, in the State of New York, on Wednesday, the 5th day of October, 1898, at twelve o'clock, noon, for the purpose of considering the *final report* of a committee appointed by the Board of Directors of this Company *to agree* with the Board of Directors of the New York Central and Hudson River Railroad Company, *upon a settlement* of the questions between the two companies, arising out of the Lease of April 1st, 1873, and the refunding of the Consolidated Mortgage Bonds of this Company, *and for the purpose of taking final action with reference to such proposed settlement and agreement.*

“ By order of the Board of Directors.

“ E. V. W. ROSSITER,  
“ Secretary.”

This notice was accompanied by the following circular :

“ GRAND CENTRAL STATION, NEW YORK,  
“ September 1, 1898.

“ TO THE STOCKHOLDERS OF THE NEW YORK AND  
HARLEM RAILROAD COMPANY.

“ At the same time with this, you will receive the legal form of notice of a meeting of Stockholders, to be held at the office of the Company at the Grand Central Station, on Wednesday, October 5, 1898, at 12 o'clock noon, for the purpose of considering the *final adjustment and settlement* of the differences between this Company and The New York Central & Hudson River Railroad Com-

pany growing out of the Contract of Lease of April 1, 1873.

“ In and by that contract, it was provided that the Central Company should pay the interest upon all bonds of the Harlem Company, including, of course, the 7% Consolidated Mortgage bonds, which are outstanding for the aggregate principal sum of \$12,000,000, and which will fall due May 1, 1901.

“ Subject to the contingencies of the litigation hereinafter mentioned, arrangements have been made to refund these bonds at maturity at an annual interest of three and one-half per cent., so as to effect a saving of \$420,000 per annum, being exactly one-half of the interest.

“ Discussion and differences concerning this saving have developed between the two Companies as follows :

“ Under the advice of eminent counsel, the Central Company contends that the Central Company is entitled to all of the interest saving effected by the favorable refunding of the Harlem debt.

“ On our side, also with the support and under the advice of competent counsel, the Harlem Company asserts that by the express provisions of the Lease of April 1, 1873, the Harlem Company is entitled to the whole of this interest saving.

“ Thus encouraged by legal opinions diametrically opposed, the two Companies have become involved in a litigation now pending, as the result of which either one or the other must gain either the whole or none of the benefit to be effected by the proposed saving in annual interest ; and which, in any event, must long delay the settlement of the question.

“ As the point in difference is a fine one, and the possibilities of judicial interpretation are various and uncertain, the Boards of Directors have reached the conclusion that the common ad-

vantage would be promoted were each Company now to make certain for itself a fair share of this gain by securing substantially one-half of the interest saving, and thus avoid the risk of losing all in an unsuccessful effort to gain all.

“ Under these conditions, the Board of Directors of each Company appointed a sub-committee, consisting of Messrs. Callaway, Morgan and Twombly of the Central Company, and Messrs. Van Santvoord, Freeman and Dutcher - of the Harlem Company. These committees met in joint session upon August 10 and unanimously reached the conclusion that it would be fair to adjust and settle these differences concerning the Lease of April 1, 1873, by adding two per cent. to the annual dividend to be received by the Harlem Stockholders, who thus would receive, from and after May 1, 1900, under the Lease (and exclusive of their interest in the street-railway property), annual dividends of ten per cent., instead of eight per cent., as payable prior to that date.

“ This increase in dividends to the Harlem Stockholders, amounting annually to \$200,000, is only \$10,000 less than one-half the entire interest saving, and is the nearest possible approach to exactly one-half, if an even percentage be adopted.

“ The Board of Directors of the Harlem Company regard this adjustment and settlement as desirable, and it is respectfully recommended to the *acceptance and approval* of all Harlem Stockholders at their meeting which, as above stated, has been called for October 5.

“ Yours respectfully,

“ C. VANDERBILT,

“ President.”

*“ A copy of the proposed Second Supplementary Contract may be obtained by any Stockholder, upon application at the office of the Company.”*

That this notice and the accompanying circular fully and fairly apprised the stockholders of the situation and notified them that their action on the proposed contract would be "final" cannot surely be open to question.

The circular is characterized by the complaint as "partial and misleading" (Complaint, par. XIV., fol. 42). We submit that such characterization is grossly unjust, and that on the contrary nothing could be fairer or more exact than this circular. It is true that the circular omits to state (as the complaint states) "that certain favored stockholders of the Harlem Company and certain of its directors were interested in the contract for the sale of said bonds mentioned and referred to in said second supplementary contract" (Complaint, par. XIV., fol. 43); but there were several sufficient reasons for such omission. In the first place it has not been shown to be the fact that certain of the "directors" of the Harlem Company were "interested" in the contract for the sale of the bonds. In the second place, only a small minority of the stockholders were interested in that contract either directly or remotely. In the third place, the bond contract is referred to only incidentally in the Second Supplementary Agreement, and that Agreement had no legal bearing upon the bond contract which had been made by the Board of Directors in April, 1897, and had been submitted to the stockholders at their meeting on May 18, 1897.

The only reference to the bond contract in the second supplementary agreement was by way of a provision that nothing therein contained should be construed to "interfere" with that contract. The meeting of October, 1898, was not called to approve or to disapprove of the bond contract. It was called to approve or disapprove of and to take final action on the compromise agreement, and each stockholder was informed that a copy of that agreement could be obtained at the office of the company on application.

*No stockholder who signed a proxy and whose vote was cast in favor of the agreement has ever questioned*

*or objected to the vote so cast, or has claimed that he was in any way deceived or misled.*

Certainly, no stockholder who voted against the agreement or who abstained from voting or who did not sign a proxy in favor of the agreement can have been misled to his prejudice.

Only those who signed proxies in favor of the agreement can be heard to object, and they "must exercise the most active diligence in repudiating the same."

*Synnott vs. Cumberland Building Ass.*, 117 Fed. Rep. 379.

The stockholders' meeting thus called was held on the 5th of October, 1898, and the following resolutions were adopted by a vote of 146,519 shares in favor thereof as against 11,042 shares in opposition thereto (see Schedule 25, pp. 409 to 412) :

*"Resolved, 1. That the Stockholders of The New York and Harlem Railroad Company hereby do approve the resolutions by the Board of Directors of this Company, adopted June 28, 1898, and of the Committee of this Company appointed under said resolutions, adopted in joint session with a similar Committee of The New York Central and Hudson River Railroad Company, held the 10th day of August, 1898.*

*"2. That the Board of Directors and the proper officers of The New York and Harlem Railroad Company be, and hereby they are, authorized, in the name and in behalf of The New York and Harlem Railroad Company, and under its corporate seal, to make and execute and to deliver, to and with The New York Central and Hudson River Railroad Company, and to perform a Second Supplementary Contract, modifying and amending the provisions of the Contract of Lease of April 1, 1873, substantially as set forth in the printed draft of contract now submitted to this meeting, which hereby approves of the form and provisions of such Second Supplementary Contract."*

" The report of the Inspectors of Election having been duly received, was ordered to be filed, and the Chairman thereupon declared that the resolutions had been duly and lawfully adopted.

" Upon motion it was unanimously

*" Resolved, That the President or any Vice-President, and the Secretary of this Company, be, and hereby they are, authorized and directed in its behalf to take all such action as from time to time may become necessary or proper to carry into effect the resolutions adopted by the Board of Directors June 28, 1898, and by the Stockholders October 5, 1898 "* (p. 414).

That the Second Supplementary Contract thereupon and from that moment became binding on the Harlem Company does not seem to us to admit of any question. "Final action" had been taken by the stockholders in completion of the action of the Board of Directors. The execution and delivery of the paper by the company's officers were mere formalities, which would have been enforced by the Court in a suit for specific performance on behalf of the Central Company or in a *mandamus* proceeding on behalf of the Harlem Company. The Board of Directors could not disaffirm the action of the stockholders, nor was there any *locus penitentiae* left to the Harlem Company in its corporate capacity.

No attempt was in fact made by the directors or officers of the Harlem Company to disaffirm the action of the stockholders.

At the meeting of the board (see Minutes, Schedule 30, pp. 477 to 487) held on the 25th of November, 1898, the president (Mr. Cornelius Vanderbilt) "called the attention of the Board to the action taken at the Stockholder's Meeting *approving* the proposed Second Supplementary Contract" and also called attention to the action brought by Hitchcock, to enjoin the company and its directors "from *executing or consummating* the proposed Second Supplementary Contract." The president also laid before the board a copy of the

Hitchcock complaint and a copy of the answer of the Harlem Company and its Board of Directors by its attorneys, Stetson, Jennings and Russell, "which was then read by the Secretary." "The President further stated that Mr. Stetson and Mr. Choate, as counsel for this company, had advised that the Board should not proceed with the *execution* of the Second Supplementary Contract in advance of the decision of the Court in the suit of Mr. Hitchcock."

Therefore "the execution" of the contract was delayed; but the agreement itself was none the less a legal and binding contract unless set aside by a judgment of the Court. The directors or officers of the Harlem Company had no right or power to repudiate the agreement or to rescind it without the consent of the body of the stockholders and the consent of the Central Company, the other party to the contract.

The Second Supplementary Contract had likewise become binding on the Central Company by the action of the directors and stockholders approving the same. The directors of that company had received the report of the joint committee and had "approved" of the contract and had called a meeting of the stockholders "for the purpose of considering and *approving*" the same. The stockholders at their special meeting held October 5th, 1898, approved of the action of the board and of the joint committee and further

"*Resolved*, That the Board of Directors and the proper officers of The New York Central and Hudson River Railroad Company be and they hereby are *authorized* in the name and in behalf of The New York Central and Hudson River Railroad Company, and under its corporate seal, *to make and execute and to deliver* to and with the New York and Harlem Railroad Company, *and to perform a Second Supplementary Contract* modifying and amending the provisions of the Contract of Lease of April 1st, 1873, substantially as set forth in the printed draft of a contract now submitted to this meeting, *which hereby approves of the form*

*and provisions of such Second Supplementary Contract (p. 260)."*

This resolution was adopted by a vote of 646,366 shares as against 2,635 shares (p. 262). Thereupon it was further "unanimously"

*"Resolved, That the President, or any Vice-President, and the Secretary, or any Assistant Secretary of this Company, be, and they hereby are, authorized and directed in its behalf, to take all such action as from time to time may become necessary or proper to carry into effect the resolutions adopted by the Board of Directors at meetings held June 22nd and August 25th, 1898, and by the stockholders at meeting held this day"* (p. 263).

At a meeting of the Central Board, held November 25th, 1898 (see Schedule 31, pp. 489 to 491), the following took place :

"The Chairman stated to the Board that at the special meeting of the stockholders held at Albany, October 5th last, the Second Supplementary Contract between this Company and the New York and Harlem Railroad Company, *agreed to by the committees* of the two companies respectively in joint session on August 10th last, *was approved* by a majority of the stock voted.

"The Chairman also stated to the Board that at the special meeting of the stockholders of the Harlem Company, held October 5th last, the *said contract was also approved* by a majority of the stock voted, but that on the 29th of September last one Thomas Hitchcock, a stockholder of the Harlem Company, had commenced in the Supreme Court, New York County, an action against this Company, the Harlem Company, Cornelius Vanderbilt, and six others, all Directors in this Company and in the Harlem Company, in which action the plaintiff seeks to have the *execution* of

the Second Supplementary Contract, or of any like contract, perpetually enjoined, and the issues raised in the action begun by this Company against the Harlem Company in 1897 adjudged in favor of the Harlem Company.

“That answers have been put in in the Hitchcock action by this Company separately and by the Harlem Company and individual defendants together, and that an application for a preliminary injunction in his action by Hitchcock is probably delayed by reason of a temporary and revocable stipulation between Hitchcock’s attorneys and the attorneys for the Harlem Company and individual defendants, to the effect that prior to the *formal execution* of the Second Supplementary Contract reasonable notice of any intention so to execute shall be given Hitchcock’s attorneys.”

The above proceedings of the Central Board show that that board was notified on November 28th, 1898, of the final action which had been taken by the stockholders of the Harlem Company at their meeting on October 5th, 1898.

That the Harlem Board also had notice of the final action which had been taken by the Central stockholders at their meeting of the 5th of October, 1898, is shown by the following extract from the minutes of the meeting of the Harlem directors of the 25th of November, 1898 :

“After some discussion, upon motion, and by the affirmative vote of all present, it was

“*Resolved*, That The New York and Harlem Railroad Company hereby approves, ratifies and confirms the action of its attorneys, Stetson, Jennings and Russell, in making, in its behalf, the answer to the complaint of Thomas Hitchcock, plaintiff, which answer was served upon the plaintiff’s attorneys November 17, 1898.

“*Resolved*, That until the final determination of said action of Thomas Hitchcock, plaintiff, against

The New York and Harlem Railroad Company and The New York Central and Hudson River Railroad Company, no action be taken by the officers of this Company in execution or completion of the Second Supplementary Contract proposed by the Joint Committee of the Board of Directors of the two Companies, and *approved by the several stockholders* October 5th, 1898,

“*Resolved*, That the President and Secretary be, and hereby they are, authorized, in the name and behalf of this Company, and under the corporate seal, to make, execute and deliver an Agreement with the New York Central and Hudson River Railroad Company and Messrs. J. P. Morgan and Company and Messrs. J. S. Morgan and Company, substantially in the form of that now submitted to this Board and annexed to the minutes of this meeting, concerning the issue and negotiation of the new bonds of this Company in retirement of its Consolidated Mortgage Bonds.

“*Resolved*, That the Secretary be, and he is hereby, *directed to transmit a copy of the foregoing proceedings and resolutions to the New York Central and Hudson River Railroad Company.*”

The answers of the two corporations in the Hitchcock suit further show that the action of the directors and of the stockholders of each corporation authorizing and approving an agreement signed and attested by Mr. Callaway (Central President) and Mr. Rossiter (Harlem Director) representing the two committees had been reduced to writing, and had been communicated to and received by the other corporation (Harlem Answer, pp. 447-8; Central Answer, p. 471). This was sufficient even to meet the requirements, if any, of the Statute of Frauds (*Argus Company vs. Mayor of Albany*, 55 N. Y., 495).

Thus it appears that each company had fully and irrevocably agreed to the Second Supplementary Contract and that nothing remained to be done but to formally execute and mutually deliver the written agree-

ment, and that this formality was stayed by the commencement of the Hitchcock suit. Nothing, however, short of a final judgment in that suit or in some other suit or a mutual agreement of rescission between the two companies could operate to relieve either company from its legal obligations under the contract.

It follows, therefore, that the transactions in 1900 connected with the settlement of the Hitchcock suit and with the indemnity agreement have no relevancy whatever as affecting the rights or liabilities of the two companies or as throwing any light on the *bona fides* of the contract which had been fully and finally agreed to in 1898 and thus had become absolutely binding on both companies.

3. *The transactions with regard to the indemnity agreement and the settlement of the Hitchcock suit are in no respect inconsistent with the good faith of the directors of either company.*

It appears that, from the time when it was commenced, in September, 1898, the Hitchcock action dragged along until April, 1900, without having been tried or disposed of. The Second Supplementary Contract, which, as we have already pointed out, had become legally binding upon the two companies on the 5th of October, 1898, the execution and delivery of the formal document being held up because of the pendency of the Hitchcock action, was by its terms to go into operation on May 1, 1900, at which date the Consolidated Mortgage Bonds were to mature, and the new refunding bonds were to commence running.

The purpose and object of the directors and the stockholders of the two companies in entering into the Second Supplementary Contract was to anticipate the situation which was to arise on the 1st of May, 1900, and to relieve the officers and directors of the two companies from the uncertainty as to the rights and obligations of the two companies under the lease, and to substitute for that uncertainty a definite plan of action binding upon both

companies. The pendency of the Hitchcock suit frustrated the object and purpose of the Second Supplementary Contract, and kept the subject-matter of the agreement an open one. The directors of the two companies, therefore, found themselves confronted by a situation which would leave them in the same embarrassing position in which they had been placed by the opposing advice of counsel, prior to the making of the Second Supplementary Agreement. The question of the rights and the liabilities of the two companies, which, in one sense, in 1897, had been an academic question was now about to become a practical and immediate question. So long as the Hitchcock suit should be pending, the directors of the Central Company could not pay, nor could the stockholders of the Harlem Company receive, the additional dividend provided for by the Second Supplementary Contract. For, under the original lease and the First Supplementary Contract, the interest on the Harlem bonds had been paid by the Central Company to the Harlem bondholders directly and not through the Harlem Company (Central Answer, p. 454), and until the determination or the compromise of the existing difference, of course the Central Company would decline to pay anything more than the three and one half per cent. interest on the new bonds.

In the Hitchcock complaint there was no allegation attacking or involving the motives or the integrity of the directors and therefore the character of that suit could be measured in the exact terms of its pecuniary value to Hitchcock. It could not have been disposed of otherwise except by final determination in the Court of Appeals, and not having been begun until September, 1898, it could not possibly be finally determined within two years, nor until long after May, 1900. Besides involving the construction of the lease the Hitchcock complaint also prayed that the two corporations be restrained from carrying out the compromise agreed upon and it was so timed that the terms of the compromise agreement could not be carried out without going directly in the face of these prayers.

Pursuant to the understanding between counsel *the formal execution* of the Second Supplementary could not be had until after reasonable notice of any intention so to execute should be given to Mr. Hitchcock's attorneys (Stipulation, p. 490).

The vast majority of stockholders had committed themselves and their directors to the policy of not trying this issue, but of carrying out the compromise instead, and the directors stood under definite instructions not to try out these issues but to execute, deliver and carry out the compromise agreement. Therefore at the last moment of time to which they could safely delay such action it was reasonable and proper that the directors should acquiesce in conditions which enabled them to act, as clearly it was their duty to act.

To substitute certainty for uncertainty, in the interest of both companies and of the stockholders of both companies, it was deemed wise, that the Hitchcock suit should be got out of the way. The Harlem answer in that suit (p. 449) fully and frankly declared to all, the purpose of the Harlem Board at the earliest possible opportunity to obey the will of the stockholders at their meeting and "*unless enjoined or restrained by order of this Honorable Court \* \* \** to carry into full effect the said proposed settlement and adjustment, and to cause ts be executed and delivered the said Second Supplementary Contract." Therefore, Hitchcock was settled with, and the suit was discontinued; and, thereupon, the paper writing evidencing the Second Supplementary Contract was formally executed and delivered, and performance thereunder was begun on the next date for paying dividends to the Harlem stockholders.

We submit that the settlement thus effected in no wise indicates any lack of confidence on the part of the directors of either company in the justice or the legality or *bona fides* of the second supplementary contract, but, on the contrary, it indicates a desire to carry into effect what both parties to the agreement regarded as a binding contract, and to free the situation from embarrassing litigation.

It is insinuated, though not directly charged, that this settlement of the Hitchcock suit was effected at the instance of and for the benefit of Messrs. J. P. Morgan & Company in order to expedite the sale of the bonds and the realizing of the profits to accrue from such sale to the Morgan syndicate. We have already discussed this subject of the Morgan contract beyond all reasonable limits, especially in view of the repeated statements of the Referee upon the trial that there was no evidence of any unfairness in the Morgan contract or of any relation between the Morgan contract and the action of the Harlem directors. We shall not repeat what we have already said on this subject. In view, however, of the statement in the stipulation of facts that the consideration for the settlement of the Hitchcock suit was "200 shares of stock of the New York and Harlem Railroad Company, furnished through or by J. P. Morgan & Company," it is proper to call attention to the circumstance that the agreement of December 1, 1898, between the Central Company and the Harlem Company and the Messrs. J. P. Morgan & Company and J. S. Morgan & Company had made the settlement of the Hitchcock suit a matter of absolute indifference to either company or to the Morgan Syndicate, so far as concerned the sale and negotiation of the refunding bonds of the Harlem Company. That agreement, as adopted at the meeting of the directors of the Harlem Company on November 25, 1898, and which went into effect on December 1, 1898, will be found at pages 479 to 487, inclusive. The effect of that agreement was that the sale and negotiation of the bonds should be in no respect affected by the pendency of the litigation in the Hitchcock suit which "shall be heard and be decided in the same manner and to the same effect as if the execution of the said mortgage to the Guaranty Trust Company, and the issue of bonds thereunder had been delayed to await such decision or decisions and as if this agreement had not been made" (p. 486). (Indeed, the testimony shows that long prior to the discontinuance of the Hitchcock suit the bonds

had been sold to Messrs. Harvey Fisk & Sons, and by them in large part resold, *to be delivered when and as received.*

The intervention, therefore, of Messrs. J. P. Morgan & Company in the settlement of the Hitchcock suit had, and could have, no connection whatever with the interest of those firms in the bond transactions.

Notwithstanding the discontinuance of the Hitchcock suit, however, there was still left a small minority of the stockholders (23 out of 770 or 3 per cent.) whose capacity for litigious attacks upon the directors of the Harlem Company and upon the Second Supplementary Contract had not yet been exhausted. This small minority of 3 per cent. represented, it is true, less than 12,000 shares out of the total 200,000 of the Harlem Company, that is to say, less than 6 per cent. of the entire capital stock, as against the 94 per cent. that acquiesced in the second supplementary contract, and desired that the same should be carried into effect, and that increased dividends should be paid thereunder immediately without incurring the certain delay and possible risks of litigation. Recognizing, however, and realizing the possibilities of litigation which this small minority of stockholders possessed, the Harlem directors, being men of large wealth, naturally hesitated before taking any affirmative step in executing or carrying into effect the Second Supplementary Contract, lest at some time and in some court they should be held to have incurred some personal responsibility by reason of such action. Therefore very naturally they desired some indemnity against personal liability which might result from any further steps that they might be called upon to take as directors in carrying out the provisions of the compromise agreement. Indeed the possibility of some such an attack had been foreshadowed in December, 1896, in the opinion (p. 79) of Mr. Trull.

The Hitchcock suit was discontinued on or about April 4, 1900 (Art. 28). The indemnity agreement was dated April 4, 1900 (see Minutes of Executive Committee of Directors of Central Railroad, Schedule 32, pp. 491-494).

The danger apprehended by the directors of the Harlem Railroad proved to be no merely imaginary danger, for the present suit (with the minatory demand annexed to the complaint) was shortly afterwards commenced and has been since vigorously prosecuted.

On the other hand, so far as the Central Company was concerned, although certain Central stockholders, Mr. Andrew D. White and his Syracuse associates, had objected to the proposed compromise and had voted against it in the stockholders' meeting, no litigation had been instituted or threatened on behalf of the dissenting stockholders.

The Central Company was the company whose obligations under the lease had been in dispute and whose funds were to be used to pay the increased dividends, if any were to be paid, to the stockholders of the Harlem. It was natural, therefore, and proper that that company should take the initiative in bringing about a settlement of the Hitchcock suit and should also agree to indemnify the Harlem directors against personal liability.

It is to be observed, further, that in legal effect the so-called indemnity by the Central is merely the contingent promise of the Central to pay to the several Harlem directors, and thus through equitable subrogation to every dissenting Harlem stockholder, such sum, if any, as ultimately should be adjudicated to have been due and unpaid by the Central Company on account of rental under the lease, if the compromise were set aside. It is virtually the same as would have been an agreement by the Central Company to provide a fund out of which to satisfy any judgment recovered by any dissenting Harlem stockholder in respect of any rights against the Central Company under the lease, and to indemnify the Harlem directors against the trouble and cost of any litigation with reference thereto. The case is one in which the party directly in interest made what is equivalent to an agreement of restitution, in case of judicial reversal, and is not one in which a third party, having no relation to the

transaction, agreed to indemnify the Harlem directors generally against the consequences of their official action. The Harlem directors honestly and fairly could and did say: While we are prepared to obey the direction of the overwhelming majority of our stock holders, we do not feel called upon to expose ourselves even to any possible risk of litigation through the action of a small minority of malcontents; and the Central directors fairly and honestly could and did say: We are perfectly willing to indemnify you against such risk, because our indemnity exactly equals that which would be our obligation and your dissenting stockholders' rights in case it shall be decided that the settlement should not have been consummated.

That the officers and directors of the Harlem Railroad Company could have been compelled, by a suit for specific performance on the part of the Central Railroad, to execute and deliver, and to perform the provisions of, the second supplementary agreement, must, we think, be recognized. In such suit, however, this small minority of dissenting stockholders of the Harlem Railroad would have intervened, and a long litigation would have resulted, with the same situation as existed in the Hitchcock suit. In order to avoid the delay and uncertainty arising from such litigation, it was deemed advisable by the directors of the Central Company, to take a short cut, procuring a discontinuance of the Hitchcock suit and to that end to indemnify the Harlem directors.

So far from indicating any doubt on the part of the Central Company of the justice and propriety of the compromise agreement, the giving of the indemnity indicates the highest confidence on its part. The indemnity would not have been advised by counsel for the Central Company had not such counsel been thoroughly satisfied that no personal liability on the part of the Harlem directors would ever be incurred.

However, from our point of view, it makes no difference what was the state of mind of the directors of the Harlem Company or of the Central Company, at the time of the settlement of the Hitchcock suit and the giving of

the indemnity agreement. Their state of mind on April, 1900, has no legal bearing upon the situation. The rights and liabilities of the parties must be determined by what had taken place prior thereto; and the *bona fides* or *mala fides* of the transaction must be determined as of the date when the Second Supplementary Contract had been submitted to and approved by the stockholders, in October, 1898. Even though we were in error in our conviction that the relations of the two companies and their stockholders had then become fixed in law, certainly, in good faith to each other they were bound to consummate the compromise; and their subsequent acts in completion of their honorable agreement cannot determine the character of that prior agreement (*Metropolitan Co. vs. Manhattan Co.*, 11 Daly, at page 467).

In any event, these transactions in April, 1900, can have no probative force or effect in supplying omissions in the testimony for the plaintiffs as to the *mala fides* alleged or claimed to exist in the transactions of 1898 or in overcoming the affirmative testimony in favor of the *bona fides* of such transactions. They could be of value, though of only slight value, merely as a make-weight in aiding the Referee in coming to a conclusion in case the testimony as to the *mala fides* or *bona fides* of the transactions of 1898 were conflicting and uncertain. Even in such case, we do not admit that the transactions of April, 1900, would tend to show *mala fides*, or would throw any light whatever upon the prior transactions. But in the case actually presented to the Referee upon the testimony before him, we insist that the transactions of April, 1900, can in no respect avail the plaintiffs, even if open to the construction placed upon those transactions by the plaintiff—a construction that in our view is wholly unwarranted.

#### IV.

**No question of constructive fraud by reason of the common directorship of the majority of the two boards can arise in this case.**

(a) The action taken by the Board of Directors of the Harlem Railroad, appointing the committee to confer with the committee of the Central Company directors to negotiate a settlement, and calling a special meeting of the stockholders to pass on the same (which was the only meeting of the Harlem directors which took any affirmative action upon the subject matter of the compromise prior to its adoption by the stockholders), was held on the 28th of June, 1898. At that meeting there were present eight directors, of whom only three were directors also of the Central Company (see Art. 20). Therefore, there were five directors of the Harlem Company who were under no disability by reason of their being also directors of the Central Company, those five directors constituting a clear majority of the members of the board present, and being sufficient to adopt the resolution without the vote of the three common directors. Of those five directors, composing the majority of the members of the board present—viz., Messrs. Dutcher, Freeman, Van Santvoord, Robertson and Rossiter—only one held any stock in the Central Company (Mr. Dutcher), and he held 100 shares in each company; his interest, however, in the compromise agreement being, as we have already shown several times, much greater on the Harlem side than on the Central side.

(b) The compromise agreement was authorized, though it was not in express terms adopted by the Board of Directors of the Harlem Company. It was proposed, formulated and, subject to stockholders' approval, adopted by a fully authorized joint committee of the two Boards of Directors, the committee repre-

senting the Harlem Company being composed of three members, of whom not one was a director of the Central Company, and only one was a stockholder in the Central Company, his interest under the compromise agreement being much larger as a Harlem stockholder than as a Central stockholder. The Harlem Committee consisted of Messrs. Van Santvoord, Freeman and Dutcher, whose relations to the two companies we have already sufficiently pointed out.

(c) Though formally adopted by the Directors at a Directors' Meeting, and by a disinterested Committee of the Board possessing plenary power, the compromise agreement became operative solely because of the actual approval of the stockholders of the Harlem Company at a stockholders' meeting.

We have already discussed in detail the history of the negotiation and adoption of the contract, and shall not now recapitulate what we have already said on this subject. The situation is precisely the same as existed in the case of *Gamble vs. Queens County Water Co.*, 123 N. Y., 91.

As the original resolutions of the Directors' made the contract operative upon its ratification by the stockholders the contract owed its legal sanction to the Board of Directors, its formulation to the Committee and its operative effect to the stockholders. The whole subject matter of the contract was referred to the committee of the board with plenary power, with directions to report to the stockholders at a special meeting to be called for the purpose of taking final action thereon.

In the *Gamble case*, it appears that one Mullins, who was a director of the Queens County Water Company, made a contract with the company, by which he sold the so-called Rockaway Beach extension to the company of which he was a director, he being the owner of the extension. The contract, however, was not made with the Board of Directors but with the stockholders, at a regularly convened meeting. The Court says, at page 102 :

“ Of course, when he came to sell it to the company, if the sale were made by him as vendor to the directors, he being one of them and acting as such, the sale was a voidable one, liable to be set aside at the suit of the company, and possibly at the suit of a shareholder ; but we have seen that this was not the way in which the sale was made. Mullins did not act in his capacity of director at any meeting of the Board, but he voted as a shareholder to make the purchase, at a meeting of the shareholders, under the circumstances already mentioned.”

In the case of *Hodge vs. The U. S. Steel Corporation* decided by the Court of Errors and Appeals of N. J., 54 Atl. Rep., 1, the board of directors had made “ a tentative contract,” which contract was “ to be subject to the approval of the stockholders,” and was subsequently approved by the stockholders, and it was held that

“ at a duly convened meeting of stockholders, they may lawfully enter into, or authorize a contract between the company and a third party in which directors are personally interested, if it is done by them with notice of such interest.”

(d) The vote of the stockholders at the meeting at which the Second Supplementary Contract was adopted was not controlled by the directors, and a clear majority of those voting were disinterested stockholders who had no personal or pecuniary interest adverse to that of the minority stockholders.

We have already sufficiently discussed this subject under our previous heads, and shall not now recapitulate.

(e) Even if this had not been the case, the action of a stockholders' meeting is sufficient to validate a contract otherwise voidable by the corporation on the ground of constructive fraud because made between the corporation and a director thereof or between two

corporations having common directors, even if the directors themselves vote at the meeting and even if their vote be necessary to a majority vote.

It is well-settled law that stockholders voting at a stockholders' meeting do not act in any fiduciary capacity towards their fellow stockholders, and, in the absence of actual fraud or bad faith, every stockholder has a right to vote for his own interests, even though those interests be adverse to the interests of his fellow stockholders. It has also been repeatedly held that a director of a corporation has a right to vote as a stockholder in a stockholders' meeting in favor of a contract between the corporation and himself, even though he is disqualified from so voting at a directors' meeting.

In view of the facts in this case, these questions become purely academic, and we shall not stop to discuss them, merely calling the attention of the Court to the cases above cited, in which that doctrine is laid down, and also to the case of *N. W. T. Co. vs. Beattie* (L. R., 12 App. Cas., 589), approved by the Court of Appeals in the *Gamble case*, 123 N. Y., at page 98.

The case of *Hodge vs. U. S. Steel Corporation*, above referred to, summarizes the law as follows:

“ At a meeting of the stockholders of a corporation, owners of shares are under no disability to vote because they are also directors of the corporation. They do not vote in their fiduciary capacity, but, like other stockholders, in the right of the shares held by them. \* \* \* The rule that directors can not lawfully enter into a contract in the benefit of which even one of their number participates, without the knowledge and consent of the stockholders, is the settled law of this State. Such a contract is voidable, at the option of the corporation, but is not void *per se*. When the facts are disclosed to the stockholders, it may be subsequently ratified by them.”

See, also,

*Bjorngaard vs. Goodhue Co. Bank*, 49 Minn., 483; 52 N. W. Rep., 48.

*Burland vs. Earle*, *Privy Council*, Nov. 1901 ; App. Cas., 1902, Vol. I., p. 83.  
*Socorro Mountain Mining Co. vs. Preston*, 17 Misc., 220.  
*Windmuller vs. Standard Distilling & Distributing Co.*, 114 Fed. Rep., 491, and 115 Fed. Rep., 748.

## V.

**The vast majority of the Harlem stockholders have acquiesced in the compromise agreement, and have accepted for over three years their increased dividends thereunder.**

As we have already pointed out, over 97 per cent. of the Harlem stockholders holding over 94 per cent. of the stock have accepted the benefit of the agreement, have received their increased dividends thereunder and have thereby acquiesced in the agreement. Less than three per cent. of the stockholders holding less than six per cent. of the stock have refused to accept their increased dividends or are seeking to annul the agreement.

The assenting stockholders have acted with full notice of their rights and have so acted for over three years.

The following notice was sent to each stockholder with the first payment under the compromise agreement :

(See Schedule 34, p. 497) :

“NEW YORK CENTRAL & HUDSON  
RIVER RAILROAD CO.

“TREASURER’S OFFICE.

“GRAND CENTRAL STATION, }  
“NEW YORK, July 2, 1900. }

“Enclosed please find check for dividend of FOUR AND ONE-THIRD PER CENT. on the stock of the NEW YORK AND HARLEM RAILROAD COMPANY, payable this day, being the regular guaranteed FOUR PER CENT. dividend under the lease of April 1, 1873, and IN ADDITION THERETO ONE-THIRD OF ONE PER CENT.—as a *pro rata* payment from May 1, 1900—in accordance with the provisions of, a Second Supplementary Contract between the companies, taking effect that date, under the terms of which this company agrees to pay an extra one per cent. on the stock of the New York and Harlem Railroad Company on January 1st and July 1st of each year, during the continuance of the original contract of lease, by reason of refunding, at a lower rate of interest, the Harlem Consolidated Mortgage Bonds which matured May 1, 1900.

“No acknowledgment is necessary.

“Respectfully,

“E. V. W. ROSSITER,

“Treasurer.

“Prompt Notice of any Change of Address should be given.”

A copy of this notice was sent to each Harlem stockholder (Article 37). From July 1, 1900, to January 1, 1902, the Central Company paid to the Harlem stockholders \$308,633.80 in excess of the semi-annual payments required by the lease of \$2 per share (Article 38). Since January 1, 1902, four semi-annual payments have accrued under the compromise agreement, amounting to upwards of \$400,000.

Out of 770 stockholders owning 200,000 shares, only 23 stockholders owning 11,653 shares, have declined

and have continued to decline to accept payment under the second supplementary contract. "*Every other stockholder of the New York & Harlem Railroad Company has accepted and retained payment from the New York Central & Hudson River Railroad Company at the rate and under the terms of the said second supplementary contract*" (Article 38).

We submit that under these circumstances a court of equity will not set aside the compromise agreement at the instance of the minority, and against the wishes of the overwhelming majority of the stockholders. Certainly a court of equity will not under these circumstances set aside the agreement in the absence of the clearest evidence of gross fraud and imposition practiced upon the minority (See Metropolitan case and Beveridge case in Appendix).

We confidently assert that in this case, there is a total absence of such evidence, and that there is no ground shown for substituting the wishes of the minority for the will of the majority; but that, on the contrary, the compromise agreement adopted and approved by over 97 per cent. of the stockholders of the Harlem Company and acted on for upwards of three years by the directors of the Central Company is just, fair and righteous, and should be upheld and enforced.

In corporate management action must be taken according to the judgment of either the majority or the minority. In common sense, and at common law the majority presumptively is right, and in this case the presumption is not to be abandoned merely because the minority has attempted to make up for its numerical insignificance by the violence of its attack upon the majority and upon the long-trusted, honorable, disinterested and extraordinarily successful management of the corporation whose stock has advanced from 300 in April, 1897, to over 400, where it now stands.

WM. B. HORNBLOWER,  
FRANCIS LYNDE STETSON,  
FRANK LOOMIS,  
HENRY B. ANDERSON,  
Of Counsel for Defendants.

## N. Y. SUPREME COURT,

COUNTY OF NEW YORK.

CONTINENTAL INSURANCE COMPANY  
and others,  
Plaintiffs,

AGAINST

NEW YORK AND HARLEM RAIL ROAD  
COMPANY and NEW YORK CENTRAL  
AND HUDSON RIVER RAIL ROAD  
COMPANY,

Defendants.

Before the Hon.  
CHARLES ANDREWS,  
Referee,  
9 February, 1904.

**DEFENDANTS' REPLY  
TO MR. MILBURN.**

The foregoing principal brief was prepared in advance of the oral argument on January 14-15, and before any disclosure of the grounds or the extent of the plaintiff's claims other than as exhibited in the complaint, and in the arguments upon defendants' motion at the opening of the plaintiffs' case, to dismiss the complaint.

Now that the claims and the theory of the plaintiff though shorn of some of their original features, have been presented finally by Mr. Milburn with his usual grace and skill in his ingenious and interesting closing argument, it is deemed proper that this reply to that argument should be separately presented; the several authorities being printed at length in the *Appendix*.

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NOTE.—After this reply had been struck off in printer's proof, we received Mr. Milburn's final revision of the Stenographer's notes of his oral argument. In many instances he has omitted portions of his argument as reported by the Stenographer, and in other instances he has changed the phraseology. However, we do not feel bound generally to change our reply to his argument as actually made.

## SUMMARY OF MR. MILBURN'S ARGUMENT.

## FIRST. AS TO COMMON DIRECTORS.

"By reason of a majority of the Boards of the Central and Harlem Companies consisting of the same men, they were incapacitated from carrying on a controversy, and adjusting it by a settlement." Therefore the compromise made, worked out and effected through such common directors was ineffective and inoperative.

(1) "Conceding that in some matters of pure business arrangement" common directors might act, nevertheless "whenever there is a controversy, as to all matters involved as in this suit," two boards, in each of which a majority are members also in the other, *are totally incapable to act*. In his oral argument (unrevised) Mr. Milburn said :

"Where there is a majority of two Boards made up of the same men, when a question of conflict arises between them they cannot sit one day and determine what A corporation's rights are, and what it shall insist upon, and the next day sit and determine what B corporation's rights are and what it shall insist upon, and the next day sit as A corporation again and come between themselves to some disposition of the matter. *I say that there is a total incapacity* (but I would not have your Honor think that I have to maintain that position in this case). I think that follows from the nature of things." THE REFEREE: "That raises the question whether such acts are void or voidable, or both." MR. MILBURN: "As I look at it, what they did towards settling this compromise amounted to nothing; *it accomplished nothing*. \* \* \* It was really the same organic body representing both sides and *their whole action was null*. \* \* \* There is only one conclusion to be drawn: that the idea of a dispute here and a settlement is a mere matter of form, pure mockery of a real transaction."

(2) "So I say, *and the Courts have said so* in considering these questions that the pecuniary interests of a man being greater in one than in another, cuts no figure. The Court does not enter into a mathematical computation to ascertain what proportion of

## SUMMARY OF MR. MILBURN'S ARGUMENT.

" a man's interest is one way and what proportion is  
 " another way. \* \* \* The stockholders in each  
 " corporation have a right in any matter between those  
 " two corporations to have a man who has no interest  
 " in the other corporation; it does not matter what his  
 " interest is *if it is a substantial one*. And that is my  
 " position, exactly as to the relations of these men to  
 " this matter; and, furthermore, I say that the pecuni-  
 " ary results to any man are not a material consider-  
 " ation here, not at all. \* \* \* A man could  
 " disregard his pecuniary interest, and yet act in such  
 " a way as to give the stockholders of his company  
 " cause of complaint."

In support of his legal proposition, Mr. Milburn quoted a part *and a part only* of Section 644 of Taylor on Corporations. We shall refer hereafter to the omitted part.

SECOND AS TO THE INHERENT CHARACTER OF THE  
 TRANSACTIONS CULMINATING IN THE COMPROMISE AGREE-  
 MENT.

" The intention was formed of dividing this interest  
 " between the two companies, and that was carried out  
 " by various steps and proceedings and transactions in  
 " the form of a compromise, which were not real genu-  
 " ine transactions conducted by opposing parties to  
 " settle a real contest between conflicting interests."

THIRD. AS TO THE STOCKHOLDERS' MEETING.

The serious question in the case, a question not to be blinked, according to Mr. Milburn, is that of the stockholders' meeting.

This question Mr. Milburn has answered to his own satisfaction by saying (*a*), the stockholders' meeting was but part of the general scheme, and therefore, as a part, as ineffective as the whole; (*b*) the question was not presented fairly to the stockholders, because (1) the notice failed to disclose " that the directors " were not competent under the circumstances to pass " upon the question, and it had to be referred on that " account to the stockholders "; (2) the stockholders were not reminded that the Harlem Company had resources, property and credit, out of which it could

## SUMMARY OF MR. MILBURN'S ARGUMENT.

have paid off the consols,\* thus obtaining the benefit of the entire interest salvage ; (3) the *simulacrum* of a compromise should not have been put forth as a real thing, nor should it have been recommended for acceptance ; (4) only the question of compromise, and not a fully prepared agreement of compromise, should have been submitted ; (5) the compromise was not adopted by a disinterested vote representing an absolute majority of the total Harlem stock, and (6) the fact of the Hitchcock suit should have been made known to the stockholders either at the meeting or before any action pursuant thereto (see p. 112, *post*).

## FOURTH. AS TO THE FAIRNESS OF THE AGREEMENT.

The agreement was unfair to the Harlem and (a) it gave to the Central Company annually \$20,000 more than to the Harlem Company, and (b) it deprived the Harlem Company of the right at the end of 100 years (1) to refund at a less rate than  $3\frac{1}{2}$  per cent., or (2) from other resources to pay off the mortgage debt and thus to secure for itself the benefit of the interest salvage.

## FIFTH: AS TO THE BOND TRANSACTION.

Though the Hitchcock suit did not challenge, or interfere with, the issue of the bonds, which, as authorized by the stockholders in the spring of 1897, were to be issued under the contract of December 1, 1898, without prejudice to the rights of either company ; nevertheless the determination to realize the profit from this issue of bonds excluded the consideration of the alternative course which Mr. Milburn considers to have been perfectly feasible, viz., the payment of the consols\* from the other Harlem resources—its cash assets and credit. But, Mr. Milburn does not regard the bond transaction as an essential

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\* Here and elsewhere "consols" means Harlem Consolidated First Mortgage Bonds falling due May 1, 1900.

## SUMMARY OF MR. MILBURN'S ARGUMENT.

feature of the case though it has a bearing which he hopes he has made "reasonably clear," though his hope has not fructified even to the satisfaction of his own mind, for elsewhere he says of the bond transaction,

"It seems to wind itself in and out of this transaction  
 "as to the second supplementary contract in such a  
 "way as to make it difficult to persuade one's self that  
 "it had not some influence; whilst at the same time,  
 "it seems difficult to formulate the influence which it  
 "had."

This may be "reasonably clear," but not according to the usual clarity of Mr. Milburn's reasoning.

SIXTH: AS TO THE TRANSACTIONS SUBSEQUENT TO THE STOCKHOLDERS' MEETING.

Mr. Milburn contends that these two transactions, the settlement of the Hitchcock suit and the indemnity to the Harlem directors, may serve to throw light on the relation of the parties to the previous transactions even though the contract be considered to have been complete which he disputes.

(a) The Hitchcock suit was not, Mr. Milburn recognizes, discontinued for any reason in connection with the bonds for it did not affect them.

It could not have been because the directors supposed it affected the supplementary contract or its execution, because they considered that compromise already to have been agreed upon finally.

The settlement was because in his suit Mr. Hitchcock was challenging the validity of the contract; he was alleging and asserting that it was a breach of trust and they wanted these issues out of the way.

*"It could be for no other reason."*

"His lawsuit did not affect the bonds or the retirement of the consolidated bonds. His lawsuit only affected the validity of this supplementary agreement; that is all."

(b) The indemnity agreement grew out of the existence of the charges in the Hitchcock suit of breach of trust, and its exaction showed a fear and doubt on the part of the Harlem directors about their situation. "It meant nothing else."

The foregoing is intended to be, and is believed to be, a fair and orderly summary statement of the essential points of Mr. Milburn's argument to which we proceed now to make the following

### Reply.

At the very outset of our reply we may well call attention to two concessions by Mr. Milburn which, *if rightly understood*, seem to be decisive.

(1) *Mr. Milburn has been unable to discover, or to indicate evidence of actual fraud.*

(2) *Mr. Milburn conceded that except for the presence of common directors a compromise might have been made without any submission to the stockholders.*

This concession necessarily and properly involves the further concession that the compromise was not *per se* illegal or *ultra vires* the corporation or its board of directors.

This last concession was necessary under the decision in *Beveridge vs. N. Y. El. R. R.* (112 N. Y., 1, 2), upon conditions so similar to those in this case as to leave open only the questions of common directors, and of injustice or oppression. But, here as there, these two questions lose importance in view of the action and subsequent acquiescence of the great body of stockholders.

So important are these two concessions that they may well be presented here in their precise terms.

(1) Apparently disclaiming imputation of actual fraud Mr. Milburn says :

“Nor am I deeply concerned about the motive. I stated in the few remarks that I made to your Honor that I should not stand here to urge any considerations of fact that I do not think warranted by the testimony. I propose to be guided by that rule. I *am not here to make accusations in regard to motives, to impute fraud or corruption or vicious wrong to men when there is no issue involving such considerations.* If it stands out clearly that there was a purpose to accomplish a certain result and that result was unjust and oppressive, and it was not accomplished in a legal way, *the motives are irrelevant, whether they were bad or good.* Therefore, I narrow down my presentation of this case to the propositions which I have formulated, and on those propositions I base the plaintiff's case. I know that I have to maintain and establish them, and that is what I believe I can do.”

To Mr. Hornblower's question as to what possible interest Mr. Cornelius Vanderbilt, who recommended the settlement, could have had against the Harlem Company, in which his interest was vastly preponderant whether compared with that of others in the Harlem Company or with his own interest in the Central Company, Mr. Milburn answered :

“I said frankly here, and I said it at the outset, that *I did not pretend to know what the motive was,* evidently leading to an intention on the part of Mr. Vanderbilt or a determination that there should be a division of this saving of interest.”

Being pressed still further, Mr. Milburn answered :

“If I am to be catechised I will say that *all I have sought to particularize* was the substantial charge that this supplementary contract was illegal and a breach of trust *by reason of the constitution of these boards.*

“*Mr. Hornblower :* I merely wish to prevent the Referee from forming the idea that we have committed any complaint which has made any charge

## REPLY TO MR. MILBURN.

“ of fraud or wrongdoing on the part of these directors,  
 “ aside from what might be considered constructive  
 “ fraud.

“ *Mr. Milburn*: There are ethical distinctions which,  
 “ I suppose, might be drawn.

“ *Mr. Hornblower*: We are sensitive about ethical  
 “ distinctions in this case.

“ *Mr. Milburn*: When I begin to charge fraud, it  
 “ will not be necessary to resort to ethical distinctions.

“ But, I may say, that all the talk about fraud or cor-  
 “ ruption has come from the other side.

(2). In conceding the power of the directors, Mr.  
 Milburn said:

“ The directors were not competent under the  
 “ circumstances to pass upon the question, and  
 “ it had to be referred on that account to the  
 “ stockholders. They had a perfect right, the direc-  
 “ tors, to modify this agreement,—I think I am right  
 “ in that proposition—without the consent of the  
 “ stockholders; but throwing out of consideration for  
 “ the moment that agreement—that was a contract,  
 “ but the consent of stockholders was not necessary to  
 “ its creation in the first instance, nor to its modifica-  
 “ tion”—

In the *Beveridge* case (112 N. Y., 1-27), the  
 validity of an exactly similar modification was affirmed,  
 Judge GRAY making this statement:

“ The next step brings us, then, to the agreements  
 of October, 1881, by which the leases were modified,  
 in the principal feature of the reduction of the pay-  
 ments agreed to be made, from ten to six per cent.  
 About this action of the directors little need be added,  
 in view of the previous discussion of the extent of  
 their powers. We hold that it was quite competent  
 for them to make those agreements without any con-  
 current action or ratification by the stockholders. No  
 fraud is found or proven against them in taking this  
 action, and it seems not an unreasonable or an im-  
 proper exercise of business discretion, in view of the  
 embarrassments in which the insolvency of the Man-  
 hattan company had involved itself and its lessors.  
 “ *To have, in good faith and with apparent reasons,*  
*agreed to reduce the amount of moneys payable under*

*the lease by their company, was not an act in excess of the power of the directors, or one voidable at the instance of the stockholders. It was as much within their province and authority and as such a part of the ordinary business of the corporation, as would be the reduction of the interest secured in a bond to the corporation, or the rent reserved in a lease of some building, or any other act lying in the exercise of business judgment.*

*"The question of the exercise of such a power of management must be left to the honest and fair business discretion of the board of directors, and the only inquiry by the stockholders could be as to whether there was any fraud by which assets were wrongfully diverted. They must be presumed to act for the best interests of the corporation and to give to the management and disposition of its property their best judgment.*

*"But when subsequently the agreement of November, 1881, for the merger or transfer of the capital stock of the lessor companies into that of the lessee was, as to the New York company, given practical effect, by the exchange of upwards of fifty-eight thousand shares, out of a total of sixty-five thousand shares, that fact, under any aspect of the case, expressed the decided acquiescence of nearly nine-tenths of the corporators in what had been done. While the action of other shareholders may not, in the merging of their stock, affect any legal rights of the non-merging shareholders, it may not improperly be referred to in the endeavor to discover the sentiments of the general body of corporators as to corporate action taken by their directors. The appeal to equity, when the acts complained of are within the powers of directors and apparently uninfluenced by corrupt motives or personal interests adverse to those of stockholders, ought, at least, to be justified by some showing that these acts were improper within the belief of a fair proportion of the body of stockholders."*

Upon the basis of these concessions and this decision, the case now on argument would present no questions save those as to common directors and oppression, which questions as hereinafter considered must be answered adversely to the plaintiff if, indeed, plaintiff is entitled to demand an answer.

**FIRST. As to common directors.**

This point loses importance in this case because of the stockholders' action and subsequent ratification, but it has been urged so earnestly by Mr. Milburn as to justify a demonstration of his absolute error, both in law and in the reason of things.

The law was stated so clearly and so accurately by the Referee in his opinion declining to dismiss the complaint at the opening of the trial, that it is not now entirely clear why Mr. Milburn should have thought it desirable again to present the question or why, in seeking for a reconsideration of the Referee's decision, he should have referred to only one, and indeed to only a fragment of one authority. Mr. Taylor, in the first part of Section 644 of his treatise on corporations, does state that "when common directors constitute a majority in each board, the two boards of directors cannot, in the same transaction, *validly* represent two adversely interested corporations." But, after referring to some cases, of which one disputes his proposition, Mr. Taylor concludes with this important and accurate statement, which Mr. Milburn must have failed to see, or certainly he would have quoted it :

*"It is, however, held that contracts made by boards of directors where a majority are common to the two corporations are only voidable, and may be ratified by a majority vote at a stockholders' meeting"* (citing the San Diego case and the Burden case which are printed in the appendix).

This is the position approved by the Referee, with the addition that such ratification may also be presumed from the acquiescence of stockholders ; and in the absence of fraud or illegality such ratification will be presumed unless the directors' action be questioned seasonably by the corporation, and not merely by a minority of stockholders.

But, suggested Mr. Milburn, though common directors may originate *contracts*, they cannot originate *con-*

*troveries or compromises* susceptible of confirmation. This proposition finds no support in law or in reason. As stated by Judge VAN BRUNT in the *Metropolitan* case (*post*) where it was attempted to except compromises from the rule that rendered voidable, contracts between common directors.

"It was intimated, that although this rule was so stringent as to purchases and sales, yet that it was not applied with the same rigor to other contracts. I have failed to find any foundation for this distinction either upon principle or authority. *It may be true that most of the adjudicated cases have arisen in reference to purchases and sales, but no distinction has been made by any court between contracts of this nature and any other, which were tainted with the same infirmity. There is no reason for any such limitation, and I do not find that it has ever been attempted to be enforced.*"

Conversely it must be held that whatever the form in which, or the subject matter as to which, common directors may act, their acts are equally and similarly voidable, and equally and similarly susceptible of ratification. A trustee's *contract* tainted only by the infirmity of his representation of his *cestui que trust* is no more and no less beyond adoption by his *cestui que trust* than is the trustee's *controversy or compromise* similarly tainted.

Indeed, the admission of the power of such common directors *to contract* subject to ratification includes such a power *to compromise* subject to ratification, for certainly the power to create is larger than the power to settle or to adjust a liability.

To Mr. Milburn it seemed unthinkable that boards containing common directors could have or could compromise a mutual controversy. *There were no two parties to differ. It was a made up thing. It was a simulacrum.*

In proper order we may consider the misapprehension of the facts underlying this criticism by Mr. Milburn. Now, it is sufficient to observe that the

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controversy was one that concerned and originated not with the directors, but with the stockholders of the two corporations. The directors were uttering the wishes and the purposes of their stockholders who regarded their respective rights in this salvage of interest on the funded debt of the Harlem Company with a mutual opposition that forced their several boards, whatever the personal opinion of any director, to formulate the opposing claims for adjudication, or for adjustment.

Prior to March 17, 1896, as recited by Mr. Anderson in his opinion, these mutually contradictory claims had been put forth by Harlem stockholders and also in behalf of the Central Company. On December 9, 1896, Mr. Stetson gave an opinion upon "the question" to Mr. Twombly, who desired the opinion of his counsel because "the question" had been raised by stockholders, and on December 21, 1896, Mr. Trull gave his opinion to the plaintiff, a stockholder, and not a director of the Harlem Company.

Why could not this real and existing question be formulated, and why was it not susceptible of enforcement or of adjustment by the several boards of directors, subject to the stockholders' overruling power? Each board differed physically from the other, and physically they could and they did frame the issues with perfect definiteness. A controversy between these two artificial persons acting through Boards containing common members, is less difficult of comprehension than one between two firms containing partners common to each firm. A. & B. may have a real and not a sham controversy with A. & C., notwithstanding A belongs to each firm. Under the strict rules of common law, because of its forms and not for any sensible reason (*Bates on Partnership*, §900) firms with common partners could not sue each other, but the rule is otherwise from the beginning in equity and now under the code (*Bates*, § 905; *Cole vs. Reynolds*, 18 N. Y., 74; *First National Bank of Champlain vs. Wood*, 128 N. Y., 35, Appendix cxv.).

The contest was conceivable. The compromise was conceivable. The new contract was conceivable. A contract in form and in substance between the two parties could be made by the two Boards of Directors acting subject to seasonable avoidance by the stockholders. Indeed, this is the very source of the original lease made April 1, 1873, by the Boards of Directors (Complaint, fol. 152), signed for the Harlem by W. H. Vanderbilt, *vice-president*, and for the Central by C. Vanderbilt, president (he was then president and principal owner of the Harlem), and not expressly ratified by stockholders until nine years after in May, 1882 (Article 9, fol. 23). Despite the substantial identity of the two interests supposed to control that original lease between boards containing common directors the rights of the Harlem stockholders seem to have been adequately guarded.

“The fact that some of the directors of the bank “were also directors of the cable company, does not “prevent them from being distinct corporations who “have the right to contract with each other in their “corporate capacities,” *Pauly vs. Pauly*, 107 Cal. 8.

But, we do not dispute that any and all action taken by two boards containing common directors whose presence is necessary to a quorum is voidable by either corporation within a reasonable time thereafter, ordinarily one year, as hereinafter shown.

For the purposes of the argument, we may even concede, that the pecuniary interest of the common director in favor of or against the action taken, is not necessarily a determining factor in the situation, but that every *such vote is voidable at the will of the corporation as a matter of law without reference to its inherent propriety, simply because it is the vote of a director who is under an official obligation to the other party to the contract.*

But this legal infirmity being one that may be cured by the approval or the acquiescence of

## REPLY TO MR. MILBURN.

the corporation, it becomes of great importance in determining the question of good faith, as was intimated by the Referee, to ascertain where was the real and pecuniary interest of the director; for, notwithstanding Mr. Milburn's suggestions, the law has not yet undertaken to denounce as invalid such acts of a trustee not amounting to wanton waste or oppression unless affected by a pecuniary interest.

Accordingly, we have taken great pains to exhibit most clearly the absolute and decisive truth that, with one exception, every common director voting or acting upon any question here presented, so far as concerns the result of that vote or act, was pecuniarily interested and predominantly interested on the side of the Harlem. Accepting plaintiff's view of the relative rights of the two companies, in every instance save one the vote of every common director was to his own pecuniary loss.

The one exception is that of Mr. Frederick W. Vanderbilt, whose presence and vote were not necessary for a quorum at any meeting in question, and whose annual gain, according to plaintiff's theory, would have been \$440, a sum hardly sufficient to induce belief that thereby he was induced to act in bad faith and hardly sufficient in the case of a man of his wealth to be considered "*a substantial interest*," such as Mr. Milburn conceded to be necessary to taint a vote.

The distinction that we recognize now may be illustrated by reference to the case of Mr. John B. Dutcher, one of the Joint Committee members appointed by the Harlem Company. Mr. Dutcher was not a Central director. Therefore he was under no adverse official obligation affecting his representation of the Harlem. But, Mr. Dutcher held 100 shares of Central stock. Therefore it is important to know that he held also 100 shares of Harlem stock; for thus it appears that when he voted as a Harlem director, his

## REPLY TO MR. MILBURN.

pecuniary interest in the result of his vote as a Harlem stockholder was five times greater than his interest as a Central stockholder.

*In fine, because of their diverse and inconsistent official obligations, the votes of common directors may be impeachable at the will of the corporation, as a matter of law, and irrespective of any question or comparison of pecuniary interests. But, in determining the question of good faith, consideration of comparative pecuniary interests is absolutely proper.*

Mr. Milburn stated that "the Courts have said in "considering these questions that the pecuniary interests of a man being greater in one (corporation) than "in another cuts no figure." He does not cite, nor have we found, any such statement in the reports, but if there be any such, it cannot apply to any question as to the *good faith* of common directors. Exactly such an inquiry was made, and good faith demonstrated therefrom by the Maryland Court of Appeals in *Shaw vs. Davis* (78 Md., 308; see Appendix, lxxviii).

Messrs. Davis and Elkins, common directors in the West Virginia Central Company and in the Piedmont and Cumberland Company, were charged with having voted and acted to the injury of the former company, and the Court, from an ascertainment that their interest in the West Virginia Company was larger than in the Piedmont Company, concluded that the charge was unfounded. The Court said :

"These gentlemen owned over 30,000 shares of the  
"55,000 issued shares of the West Virginia Central  
"Company, while they owned but 7,295 shares of the  
"Piedmont & Cumberland road; and that they would  
"purposely and designedly wreck their larger and  
"more valuable holdings in the West Virginia Central  
"merely for the purpose of realizing an income from  
"a smaller and dependent road, in which their aggregate  
"shares were not one-fourth of the amount owned  
"by them in the main enterprise, is quite incom-  
"prehensible."

Therefore our examination of Mr. Milburn's propositions asserting the absolute nullity of the compromise agreement, because originating with boards containing common directors concludes with our counter statement that such is not the law of this State, as the same is declared in the opinion of the Referee and in the many decisions *which are printed at length in the appendix*,\* including the decisions in the absolutely similar cases of the *Metropolitan* and *New York Elevated* railroads.

The law of this State, of England and of nearly every State of the Union is that such contracts or compromises between boards containing common directors, in absence of fraud or illegality, *are perfectly valid at law*; but that within a reasonable time the corporation may disaffirm and *in equity* may set aside the contract, but that a minority stockholder may not do so.

The doctrine is succinctly stated in the following language used by Judge VAN BRUNT in concluding his elaborate opinion in the *Metropolitan case* (largely printed in the appendix to this reply):

*“Agreements of this character are not void, but simply voidable, and if the corporation wishes to avoid them, as has been shown, it must act within a reasonable time. If the shareholders are dissatisfied with the acts of their directors, they must repudiate them within a reasonable time, which in most cases would be held to mean at the next meeting for the election of directors, when they can elect a new board, which can take the necessary action to annul the voidable contract; and it must, therefore, be the dissatisfaction of the majority of the shareholders, and not that of a minority, which can call the power into operation. If the shareholders renew the terms of office of the directors who have made the voidable contract, or if they take no action*

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\* *Booth vs. Robinson*, xv.; *Burden vs. Burden*, xliii., xlvi.; *Burland vs. Earle*, liii.; *Coe vs. Railway*, lxxxviii.; *Genessee vs. Retsof*, xli.; *Hart vs. O. & L. C. R. R.*, xxxii.; *Hodge vs. U. S. Steel*, lv.; *Jesup vs. Illinois Central*, xcv.; *Kelly vs. Newburyport*, lxvi.; *MacDougall vs. Gardiner*, lxxix.; *MacNaughton vs. Osgood*, xxviii.; *Shaw vs. Davis*, lxxviii.; *Twin Lick vs. Marbury*, xi.; *Wallace vs. Long Island R. R.*, xxiv.

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“showing plainly their dissent, the contract will become binding by acquiescence. As in most corporations boards of directors are elected by the shareholders annually, the right to annul can seldom exist for more than one year. Thus it will be seen that there can be but few cases in which the decisions of these questions can affect past action, whatever influence it may have in shaping the proceedings of trading corporations hereafter.”

Further, it is to be observed that here the contract was formulated by a qualified committee to whom the matter was delegated with full power. For the purpose of providing the stockholders with a fair agency the board honorably and justly constituted this disinterested committee, which possessed and exercised in the premises all the lawful powers of the full board (*Hoyt vs. Thompson's Executor*, 19 N. Y., 207 Appendix l.; *Olcott vs. Tioga R. R.*, 27 N. Y., 558; *Sheridan Electric Light Co. vs. Chatham National Bank*, 127 N. Y., 517-522, Appendix li.).

For all these reasons we reiterate our former statement that the validity of the compromise agreement is not now impaired by the mere fact that at any meeting, a majority of the acting Board of Directors of either company constituted a majority also of the acting Board of the other company.

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NOTE—In his attack upon common directors as incapacitated to formulate a controversy or to originate a compromise, that involved conflicting interests of their two companies, Mr. Milburn has followed a precedent set by the plaintiff in *Hodge vs. U. S. Steel* (Appendix lix.-lxv.), and overruled by the Court. In that case it was necessary that original official action should be taken by the directors, and that afterwards such official action should be ratified by two-thirds of the stockholders. It was there argued that because of their personal interests the directors' proposal had not been lawfully adopted and did not afford a valid basis for stockholders' ratification.

By unanimous vote, the Court of Errors and Appeals rejected this argument, and held that the statute had been observed in the original action of the directors, notwithstanding the pecuniary interest of the majority in the proposition there submitted to the stockholders. This adjudication sustaining such action of directors as sufficient to meet the strict requirements of a statute, goes far beyond any necessity of the present case in which the only condition is that of action good at law, but subject to avoidance in equity, and perfectly valid until so avoided.

**SECOND. As to the inherent character of the transactions culminating in the compromise agreement.**

In view of Mr. Milburn's repeatedly manifested unwillingness unequivocally to charge fraud, it is somewhat difficult to grasp the exact significance of his carefully framed statement, that from beginning to end, from Mr. Stetson's letter of April 9, 1897, to the indemnity agreement of April 4, 1900, every step in these transactions was but part of a preconceived plan intended from the beginning to result in an approximately equal division of the interest salvage. This would seem to mean little if it be not a charge of fraud.

To show that, in the course of these events, there was a progressive or logical order in itself proves nothing. If the end be lawful, the several steps lawfully taken towards that lawful end, are not to be condemned because of their orderly sequence. In its ordinary course nothing seems less the work of design than the ordinary human life, commonplace following commonplace monotonously, but yet finally revealing individual character through an unsuspected consistency of progressive actions; the several days being "bound each to each in natural piety." So, to another poet it is not doubtful that "through the ages an increasing purpose runs." But, neither to the life of the individual or of the race, nor even to the transaction now before the Referee is a sinister purpose to be ascribed merely because of the orderly unfolding of the life or the transaction. The discovery or exhibition of a prior formal scheme to which subsequent events have conformed may show that in such conformity every actor was a child of destiny, but whether that destiny has been glory or despair is to be ascertained by considering the inherent character of the events, and not merely the order of the events.

Without intended disrespect, we venture to suggest that Mr. Milburn's discovery of this order of events is

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no more significant than would have been his production of a yearly calendar showing the sequence of the days on which the events occurred. For, thus far, Mr. Milburn has hesitated to impute a fraudulent purpose, or to ascribe any motive, excepting only an original determination finally carried out to effect substantially an equal division of the interest salvage. But, in and of itself such a purpose even though thus conceived, cherished and consummated, was not unlawful. There is not one word of proof to show that it was not, but there is convincing proof to show that it was, the work of honest men, honestly endeavoring to solve a problem, which, though simple enough to the plaintiff, crying "give me everything," was perplexing to these just-minded managers justly and frankly trying to ascertain the respective rights of the owners of these two properties. Even though the plaintiff be willing to imagine, and to impute, an evil purpose, the law will do so only upon convincing proof. *Inferences all tending to evil would not be sufficient, unless excluding all reasonable inference of honesty.*

The rule was accurately stated by Judge FINCH for the Court of Appeals in *Shultz vs. Hoagland* (85 N. Y., 464-467, cited in *Guidet vs. N. Y., L. E. & W. R. R.*, 9 N. Y. St. Rep., 28, q. v.), as follows :

"The case furnishes no exception to the rule that fraud is to be proved and not presumed. (*Grover v. Wakeman*, 11 Wend., 188.) It is seldom, however, that it can be directly proved, and usually is a deduction from other facts which naturally and logically indicate its existence. Such facts, nevertheless, must be of a character to warrant the inference. It is not enough that they are ambiguous, and just as consistent with innocence as with guilt. *That would substitute suspicion as the equivalent of proof. They must not be, when taken together and aggregated, when interlinked and put in proper relation to each other, consistent with an honest intent. If they are, the proof of fraud is wanting :*"

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and also tersely by Judge DANIELS in the Guidet case (*supra*) as follows :

“ Where different inferences may be drawn from the same state of circumstances it is the duty of the Court to presume in favor of innocence rather than of intentional and guilty misconduct.”

“ Common directors owe the same fidelity to both corporations, and there is no presumption that they will deal unfairly with each other” (*San Diego vs. Pacific Co.*, 112 Cal., 53, Appendix lxxxvi.). “ It is always assumed until the contrary appears that they and their officers obey the law and act in good faith towards all their members” (*Dunphy vs. Travelers' Association*, 141 Mass., 495, Appendix lxxv.).

With reference to this line of argument put forward by Mr. Milburn in 1904 upon a review recently made of events developing slowly from 1897 to 1900 the observations of Judge VAN BRUNT with reference to a similar plea in the similar Metropolitan case seem to be exactly in point :

“ Upon an examination of the evidence in this case, and the arguments of counsel thereon, I have had forced upon my mind the conclusion, that their belief in the verity of their position was brought about by asking themselves the question : ‘ Can any good thing come out of Nazareth ? ’ by imputing bad motives when the moving cause may have been good ; by considering past transactions by the light and knowledge which subsequent events have developed ; by taking that view of the future of these properties, whether supported most strongly by the evidence or not, which best accords with their desires, rather than by according to the defendants the right of a different judgment which they might in good faith entertain, than by placing themselves in the position of the defendants with no knowledge of the future, than by imputing good motives and meeting the question with the idea that the directors of the Metropolitan company intended to do their duty by that corporation.”

Nothing more can be necessary to refute Mr. Milburn's argument so far as it depends upon the "*order of events*." But, assuming that his argument is something more, and that despite his disclaimer it involves a charge of bad faith, and recalling that under the cases above cited as well as under Judge LANDON'S ruling in *MacNaughton vs. Osgood* (41 Hun, 109, Appendix xxviii), in this suit brought by a stockholder and not by the corporation, from beginning to end the burden of proof is upon the plaintiff, we may proceed to consider the character of the events themselves.

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Often it has been sought to draw an inference as to the character of the events from the character of the actors.

Such as we have just shown was the attempt in the *Metropolitan Elevated Railway* case before Judge VAN BRUNT. "*Can any good thing come out of Nazareth?*" was the inquiry which to Judge VAN BRUNT seemed to have been in the minds of the plaintiffs in that case. The application of that test to the present transactions brings before the consideration of the Referee, one of the most admirable, honorable and conscientious gentlemen who ever received the confidence of many stockholders, and who for many years, administered his trust with a fidelity and a success which until the present unwarranted challenge of his actions, has received only praise. No successful attack upon the good faith of the compromise agreement or the events relating thereto can be sustained without impugning the honor of Cornelius Vanderbilt, who, according to the record, as President of the Harlem Company, was the first to formulate "the question" in his communication, dated February 27, 1896, to the General Counsel Henry H. Anderson, Esq.;

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who signed and issued to Harlem stockholders the criticised notice of September 1, 1898; who reported the stockholders' action to Harlem Directors at their meeting of November 25th, 1898; and who was present at the meeting upon the same subject, held by the Central Directors November 28th, 1898. At the stockholders' meeting Mr. Cornelius Vanderbilt was proxy for the 141,519 shares voted for the compromise, for which also he voted his 39,648 shares at a personal net annual loss of \$40,224.80, according to the theory of the plaintiffs as to what should have been done at that time. It was directly asserted by Mr. H. B. Anderson and recognized by Mr. Milburn that Mr. Cornelius Vanderbilt "knew what was going on and if "he did not want it, he would have gone in and "stopped it." That this compromise could not have been made without Mr. Cornelius Vanderbilt's active support is too plain for question.

In his argument Mr. Milburn, for another purpose, has emphasized the fact that for three generations the Vanderbilt family, and until his death Cornelius Vanderbilt, have been identified with these properties, and continuously have received the confidence of all the stockholders. The mere statement proves at once that the confidence was extended, and that it was deserved. What is there in the present instance to show that at last in bad faith it was abused? Nothing but the false clamor (we speak after the manner of the rhetoricians) of three per cent. of the Harlem stockholders owning six per cent. of the stock; all others continuing to approve the act of their long trusted president as being the best practicable solution in 1898. Even now without a decision of the Court of Appeals finally overruling the opinions of Messrs. H. H. Anderson, Phelps, Green and Loomis, it cannot be certainly declared that this was not absolutely the best solution of the question at issue between the two companies. Nor would such a decision by the Court of Appeals impeach the good faith of the compromise,

in the light of the conflicting opinions of counsel in view of which, in 1898, the compromise was adopted.

Hesitate though he does to make the charge, Mr. Milburn's condemnation of these successive transactions for which Mr. Cornelius Vanderbilt assumed full responsibility, means nothing unless it means an attack upon the good faith of Mr. Cornelius Vanderbilt. For such an attack the testimony not only furnishes no ground whatever, but on the contrary overwhelming and conclusive contrary evidence in Mr. Vanderbilt's own vote without regard to his vastly preponderant pecuniary interest in the Harlem. To Mr. Milburn that vote thus cast is inexplicable. But, once assume, as we are bound to assume, that Mr. Vanderbilt was acting honestly, the act is easily comprehended. In his circular of September 1, 1898, Mr. Vanderbilt stated that he considered the issue more or less doubtful, and on the whole the compromise desirable. Of course, then he would vote for the compromise, and would recommend others so to vote. Unless the good faith of Mr. Cornelius Vanderbilt be impeached, this whole attack must fail, for as stated by the Referee, and as is the settled law everywhere, the act of the directors in good faith within the lawful limits of their powers is fully adequate to a compromise such as this. The compromise cannot be set aside merely because it is beyond the comprehension of Mr. Milburn why Mr. Vanderbilt should have supported it, or because, in Mr. Milburn's opinion, the compromise was a waste of the Harlem assets. Already the Referee has held that the question of the true construction of the lease was not so clear that *per se* the compromise constituted bad faith. The Referee called for affirmative evidence of bad faith, and no such evidence has been furnished.

Mr. Milburn's concrete statement was :

“ The intention was formed of dividing this interest  
 “ between the two companies, and that was carried out  
 “ by various steps and proceedings and transactions in

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“the form of a compromise ; which were not real genuine transactions conducted by opposing parties to settle a real contest between conflicting interests.”

The first half of this statement, as we have shown, concerns merely “the order of events.” The second half of the statement, which is nothing if not a charge of fraud, has not been sustained by a particle of proof. Suspicions and inferences have been suggested, but no proof. If, as thus imputed, the original intention was not improper, and *per se* it was not, neither directness nor uncertainty in the execution of such purpose could render unlawful that which from the first was lawful.

We may turn now to the consideration of the several transactions prior to the stockholders’ meeting.

The first significant incident in the view of Mr. Milburn was the letter written by Mr. Stetson to Mr. Twombly under date of April 9, 1897. Said Mr. Milburn (before revision) :

“I remember when I first read it that it furnished me with the key to everything that was done. *I could have closed my eyes and filled out a good deal of what happened afterwards, as could any one of the counsel sitting around this table.*”

Casually, Mr. Milburn indicates a difficulty under which, in common with the plaintiff, he has suffered. They have “closed their eyes” to the simple and plain facts of the case, as viewed by those who impute to honorable men good motives and not evil motives. None are so blind as they who will not see : and either by “closing their eyes” or otherwise, the plaintiffs have put themselves in the position in which, as was observed by Judge VAN BRUNT, they take that view,

“whether supported most strongly by the evidence or not, which best accords with their desires, rather than, by according to the defendants the right of a different judgment which they might in good faith entertain.”

As now we know, after the controversy between the stockholders of the two companies had been bruited for more than a year, as shown by the opinions of Mr. Anderson of March 17, 1896, Mr. Stetson of December 9, 1896, and Mr. Trull of December 21, 1896, the several Boards of Directors upon April 8, 1897, opened negotiations for the refunding of the Harlem Consols which were to fall due about May 1, 1900. The necessity of an arrangement for refunding some time in advance of the maturity of the Consols was recognized by the Referee upon the trial. The appropriateness of a refunding at that juncture, just after the settlement of the silver controversy by the presidential election of 1896, and the refunding of the Lake Shore bonds upon suprisingly advantageous terms (p. 104), is quite apparent from the testimony. The imminence of the question and the propriety of such refunding also are indicated in the last two paragraphs of the opinion of Mr. Trull (pp. 78, 79), as well as by the fact that at the stockholders' meeting upon May 18, 1897, the plaintiff and Thomas Hitchcock voted for such refunding.

Thus the question was acutely presented for consideration by the directors, who had good reasons for being in doubt as to the respective rights of the parties :

(1) As declared by the Referee in his opinion, the rights of the Harlem were not too clear for argument.

(2) The uncertainty of any question of law had just been impressed upon the minds of these railroad directors by the very recent, though final, reversal of the construction of the so-called Sherman Anti-trust Act of 1890.

In the *Trans-Missouri* case (166 U. S., 290), only three weeks previously, by a vote of five to four, the Supreme Court of the United States had reversed the decision of the Circuit Judges, two to one, affirming the decision of the District Judge in favor of the railroad companies, and had decided that this anti-trust act embraced and prohibited all contracts in restraint of trade, whether reasonable or unreasonable. The law

thus was established against the view of a majority of the Judges who had examined the question, against the view of the framers of the law (*Hoar's Autobiography*, vol. ii., p. 366), and against the unanimous decision of several other Judges, previously rendered in the corresponding *Joint Traffic* case. To this condition, then freshly in mind, Mr. Stetson expressly referred in his letter of April 9, 1897 (p. 60, *b*).

The conditions led to honest doubt much more naturally than did those surrounding the \$13,000,000 claim in the Metropolitan case, as to which (11 *Daly*, 464-5, Appendix v) Judge VAN BRUNT justly observed :

*"I therefore say, that no matter what any lawyer's opinion may be as to the invalidity of a claim of the sum of the \$13,000,000 claim, no matter how frivolous in the opinion of some it may be, it is no evidence of fraud that its existence was recognized in this settlement."*

Mr. Milburn was careful to observe that in Mr. Stetson's letter of April 9, there is no just subject of criticism either by himself or by any one else, his only observation being that the concluding paragraph erred in suggesting the propriety of the modification of the resolutions therein referred to if a compromise were to be adopted,—Mr. Milburn's view (before revision) being that there should be

*"no modification of the resolutions, as indeed there was none, as the resolutions as drawn made the claim of the Harlem for what it was entitled to, and then, of course, that would be followed by the New York Central for what it was entitled to, and then you had in collision the acutely opposed claims for compromise, and it really would never have done for the Harlem Company to come out in asserting its position in the very beginning in a modified form, as if it were inviting compromise."*

This illustrates a difference of view between Mr. Milburn and Mr. Stetson, which would not be important enough for present discussion did it not afford basis for fair analysis and criticism of the general theory of Mr. Milburn's argument.

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Mr. Stetson's view and advice was that the documents *should conform to the truth*, and that if the Harlem Company was prepared to discuss a compromise of the claim—which was the claim not of the directors, but of the stockholders—such willingness should be indicated in the resolutions, and that the resolutions should not “commit the Harlem directors to an absolute theory inconsistent with compromise.”

Mr. Milburn's suggestion that, notwithstanding any intention and willingness to compromise, the Harlem directors should have committed themselves to an absolute theory inconsistent with compromise, could be put forth only in harmony with Mr. Milburn's preconceived notion that everything was a sham, and that the Harlem directors should define their position absolutely, even though not intending to maintain the same.

But the proceedings were not a sham, and the resolutions were put forth in their absolute form. Not until after a year's reflection did the Harlem directors reach the conclusion to accept and to favor a compromise. The fact that on April 9, 1897, Mr. Stetson suggested the possibility of a compromise, which more than a year later was carried out, in and by itself constitutes no proof that at the time of receiving Mr. Stetson's letter the Harlem directors conceived and adopted a plan of action pursuant thereto. In absence of proof the presumption must be that they were not then entering upon a course of double-dealing. The fact is that the seed of the plant thus sown in April, 1897, did not germinate or bear fruit until June, 1898.

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The next transaction, upon April 14, 1897, when the Harlem Board asserted its rights, cannot be the subject of just criticism by plaintiffs, nor was any made thereof by Mr. Milburn.

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At this meeting of April 14, 1897, the board took decisive action to refund the consols, subject to the approval of the Harlem stockholders, which was given at the meeting of the 18th of May, 1897. *Upon this day the stockholders of the Harlem unanimously and overwhelmingly, with the concurrence of the plaintiff and Mr. Hitchcock, committed the corporation to the policy of issuing new mortgage bonds to refund the consols falling due May 1, 1900* (see particularly; Complaint Articles, IX., X., XII.). More than passing notice at this point should be given to this fact, because it tends to neutralize much of *Mr. Milburn's contention that in the autumn of 1898 provision might have been made for payment of these consols otherwise than by the issue of the new bonds.* Mr. Milburn is entitled to all the credit that can attach to the origination and announcement of this idea. Certainly it was brand new upon the argument. Without proof that this expedient was ever suggested to the directors in 1898 by the plaintiff or by any one else, and in view of the fact that the expedient would defy the vote of the stockholders in 1897 authorizing the mortgage (executed and recorded in July, 1897), and also the declared theory of the complaint, it will be difficult to maintain a charge of fraud or wanton waste against the directors because they had not made use of the expedient thus tardily suggested.

At this Harlem stockholders' meeting of May 18, 1897, were presented the resolutions and the protest of the Central Directors adopted the same day upon the resolution of Mr. Twombly, based upon advice given to the Central Company that the claim of the Harlem Company was not justified by the terms of the original contract, but was in the highest degree unjust. The advice here referred to was the opinion of Messrs. Phelps, Green & Loomis (p. 53), which opinion, however, was not submitted to the Harlem meeting.

Inasmuch as the Harlem stockholders and directors then ignored and disregarded this Central communication, nothing in connection with that communication can involve or suggest the existence of bad faith on the part of the Harlem directors as such *at that time*. It is alleged however that because three of the Harlem directors, Mr. William K. Vanderbilt, Mr. Chauncey M. Depew and Mr. Frederick W. Vanderbilt, who had voted for the Harlem resolutions of April 14, constituted three of the ten directors who voted for the Central resolutions of May 18, these proceedings manifestly are a sham.

But, again we have to observe that bad faith is not to be imputed without evidence, and merely upon the occurrence of a fact otherwise colorless, and not in itself inconsistent with good faith. As above quoted from the *San Diego* case, the fact that some of the directors of one company were directors also of the other company, did not prevent them from being distinct corporations, which had the right to contract with each other in their corporate capacities; nor did it prevent one corporation from having a controversy with the other corporation.

Neither did the *personnel* of either board of directors enter into or affect the right of the board as such to formulate, and to litigate a question between the corporations, as distinct from a controversy affecting directors personally. A case may be conceived in which apparent inconsistency of such action would require explanation. For instance, assume that the Central Company was a large stockholder in the Harlem Company, and that as such Harlem stockholder it should seek to hold personally liable some Harlem director who also was a Central director. On its face it would be absurd for such a common director to vote in the Central board to prosecute himself personally as a Harlem director. Yet even in such a case, if a pure question of law were raised as to the liability of the Harlem Director, involving no charge

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of dishonesty on his part, he might properly vote as a Central Director to have a suit brought against himself for an adjudication of the question. There is neither reason nor law for the proposition that a common director may not in either board vote for the formulation and assertion of the claim of one corporation against the other.

We deny the existence of proof or of law supporting or tending to support any charge of bad faith or illegality in the transaction of the Harlem Board of Directors or of the Central Board of Directors in April or in May, 1897.

The opinion, and the obtaining of the opinion, of Messrs. Loomis, Green and Phelps, are disposed of by Mr. Milburn with the summary statement that, as he looks at it,

“with these transactions in the situation they were,  
“getting opinions from both sides, the defect in the  
“situation was that they had assumed to determine on  
“a division of this fund, and this was simply one of  
“the steps in connection with the original determina-  
“tion to make that division of the interest.”

Where is there any proof that at this time either company or any director or any officer of either company had resolved upon a division of this fund? Why is it not much more legitimate and fair, and in accordance with reason to assume that the Central directors felt it to be their duty to their stockholders to take legal advice as to the Central rights, just as they knew had been done by the Harlem directors as to the Harlem rights? The Central request for legal advice upon this question in the spring of 1897 was opportune and reasonable, and the Central directors would have been subject to just censure had they failed to obtain advice as to the rights of their corporation upon this important question.

Of course, there is, and can be, no criticism upon the counsel to whom they applied. Their standing was so

eminent that their advice, *even though it had been sought in furtherance of a preconceived plan*, could not be disregarded by any board of directors. For a moment let us turn the shield, and assume that this vigorous plaintiff and its tireless counsel had been interested only in the Central Company ; that, without dispute and without litigation, the Central Company had yielded to the Harlem Company the entire salvage of interest ; and that later it had appeared that such concession had been made notwithstanding the reception by the Central directors of this opinion of Messrs. Loomis, Green and Phelps ! Could it be doubted that in such case the plaintiff and its counsel would have made the air resonant with the charge that, in defiance of the opinion of their most eminent counsel, the Central directors had absolutely sacrificed and wasted the rights of the Central shareholders ? The very fact of the reception of this opinion of responsible counsel of the Central directors renders absolutely preposterous any suggestion of bad faith on the part of the Central directors in maintaining or in asserting the Central claim.

The opinion itself, or at least the second paragraph thereof, does not commend itself to the understanding of Mr. Milburn, which is regrettable, though not decisive of the question of good faith. Independently of its reasons, the fact of the opinion, is sufficient, unless it is to be held to have been a sham and manufactured opinion, which is inconceivable. The fact that the opinion or its conclusion is flouted by either of the counsel of the plaintiff, proves only that lawyers differ as to the law, just as the former learned counsel for the plaintiff differed from the Referee in thinking the rights of the Harlem too plain for argument. In the opinion of Judge VAN BRUNT in the Metropolitan Elevated case, already cited, reference is made to the \$13,000,000 claim, and to the famous question (affecting millions of real estate in the City of New York), as to the necessity of joining W. Coventry

H. Waddell, official assignee in bankruptcy, as defendant in a partition suit. The opinions of the wisest counsel, and *a fortiori*, of those not so wise, may be at fault; but if given and received in good faith they are disregarded at one's peril. It is commonly understood that eminent counsel considered and advised that no damages would have to be paid by the New York elevated railroads for their occupation of the streets; nevertheless, millions upon millions of dollars have been recovered and have been paid, though the contrary decision of that question involved the Court of Appeals in almost equal division, so that ultimately the decision was that of but one Judge, General TRACY, holding a place on the bench for a few months in 1882. It would be a bold man who to-day should choose to risk his reputation for learning, or his fortune upon the statement that ultimately and certainly the Court of Appeals will hold that clearly and necessarily the Harlem Company was entitled to the entire saving. It would be a still bolder man who at this juncture would dare to charge bad faith upon Messrs. Loomis, Phelps and Green, because of the opinion given by them upon this question, not even yet, finally decided.

We conclude, that nothing connected with the obtaining or the reception or the use of this opinion affords any basis for a charge of bad faith.

The occurrence next in order of time is the institution on June 29, 1897, of the Central suit, to which the attention of the Referee is invited by Mr. Milburn "because of the peculiar allegations in that complaint." "*It is plain upon the face of it that it was purely artificial, strained, simply an effort to create an apparent situation justifying a suit.*"

This is a very serious accusation against honorable men involving imputation of a fraudulent and tricky purpose. No proof is offered in support of the charge, but the truth thereof is said to be "*plain on the face of it.*"

In what feature is this fraudulent purpose thus clearly exhibited? Does Mr. Milburn believe that among 12,000 Central stockholders there was not one prepared to contend that the Central Company had some right in this interest salvage? If he does so believe, he has failed to observe that Andrew D. White and his associates declined to concede away *any part* of what they considered the Central's right to the entire salvage. This indicates what would have been the attitude of themselves and other Central stockholders had the Central directors voluntarily conceded to the Harlem the right to the entire salvage, a questionable right, not yet finally determined; by the Referee declared to be a right not too clear for argument, which, of course, implies that it was and is a question for adjudication.

The Central directors were exposed to criticism and to litigation from Central stockholders as much as the Harlem directors were open to criticism and to litigation from Harlem stockholders, as advised in Mr. TRULL's opinion of December, 1896. Under the advice of the Central counsel it was the bounden duty of the Central Company to maintain to the utmost the Central's right to this salvage. Even from the plaintiff's point of view the duty of raising the question rested on every Central director who was not also a Harlem director.

At the Central board meeting of May 18, 1897 (p. 116), where the suit was authorized, there were present ten directors, of whom five were not, and five were, Harlem directors. The resolution asserting the Central claim as advised by counsel, and directing the institution of a suit under the direction of General Counsel Loomis, Ashbel Green and Edward J. Phelps was offered by Mr. Twombly who was not a Harlem director, and who has testified to the good faith of his action. Upon this state of facts what was the duty of the five Central directors who were also Harlem directors? Unless four of them withdrew, destroying

a quorum, or unless all of them voted in the negative the resolutions would have carried. What a spectacle would thus have been presented. How could the recalcitrant five justify themselves to their Central stockholders for thus denying to them the opportunity of presenting for adjudication the controversy which, as before observed, already existed between the companies and was not the creation of the directors?

The situation is too clear to require justification. The five common directors complied with every requirement of duty in law or morals when they provided for each company the means of asserting its rights, and called in for the two companies severally and respectively two of the most eminent counsel then living, Mr. Phelps and Mr. Choate.

A moment's further consideration of this suit will show that from the Harlem point of view, it was the most desirable method of presenting the question. *Unless the Central Company took some such initiative, no test of the question at issue could be begun before July, 1900, or finally determined before July, 1903, and during at least three years the Harlem shareholders would be without any increase in dividends even though finally adjudicated to receive the same.* As heretofore remarked the Central treasurer paid directly and not through the Harlem Company, the rental to Harlem stockholders and the interest to Harlem bondholders. Therefore, in case of any reduction of interest, the salvage would remain in the Central treasury unless drawn therefrom by Harlem stockholders, who could not demand or bring suit for the same before July, 1900. Any earlier adjustment of the question could be brought about only upon the initiative of the Central, whose prompt movement, therefore, constituted no just cause of complaint by any Harlem stockholder.

The Central suit thus being properly authorized, the method of its formulation and prosecution very properly was committed to the competent counsel re-

tained for that purpose. That action is not on trial here. The institution of that action by the Central directors is urged by the plaintiff upon the attention of the Referee as a fact, that occultly suggests bad faith on the part of the Harlem directors, because one-half of them constituted also one-half of the Central board that authorized the Central suit. But, without actual proof, which is wholly lacking, bad faith on the part of the Harlem directors, or any of them cannot be inferred from the fact that any allegation was inserted in, or omitted from, the Central complaint prepared under the direction of the Central counsel. If it were necessary, and the occasion were one involving the close scrutiny of that complaint, the counsel who advised, could support and justify its allegations by explanation certainly not less satisfactory than Mr. Milburn's *apologia* for some of the allegations and omissions of the complaint in the present action. But, in any aspect, in framing a Central complaint it was the duty of the Central counsel to state the Central case as comprehensively and as aggressively as possible. That the Central complaint and its extreme statements were drafted so as to become the basis of compromise is suggested by Mr. Milburn because, shortly before, Mr. Stetson had advised that a compromise might be made, and a compromise was authorized a year later. If the existence of an actual suit in court had been a necessary condition of the compromise, the suggestion possibly might possess some though very little significance. But, the suit was merely incidental to a controversy which, without the suit, would have existed, and would have continued to exist without possibility of judicial decision until a long time after July, 1900, and neither the existence of the Central suit nor the character of the allegations of the Central complaint can determine the question of Harlem good faith in making the compromise. In the Harlem circular of September 1, 1899 (p. 238) recommending

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the compromise, the litigation is referred to only incidentally, the reasons for the recommendation given being the existence of the controversy, the contradictory advice of the respective counsel, and the long delay in the settlement *of the question*, which delay, as already observed, would have been longer without, than with, a Central suit. Therefore, we conclude that the existence of the Central suit has not been shown to be any part of a scheme, or to be a sham basis for a sham compromise.

After thus attacking the aggressive character of "the peculiar allegations in that complaint," Mr. Milburn suggests that the Harlem counsel should have demurred to the complaint, thus admitting all those allegations! The complaint herein (folio 39) points out in that Central complaint certain allegations which plaintiffs declare were incorrect and untruthful; allegations which, *if true*, would have rendered impossible much of the argument of Mr. Milburn. That such allegations should have been admitted by demurrer is a statement into which Mr. Milburn could have fallen only in the ardor of oratory or because of the difficulty of finding real ground for just criticism.

Next, it is charged by Mr. Milburn that no serious effort was made to secure a trial of the cause, which was on the calendar at one term, and not reached because of the illness of one witness, but that "if there had been any intention of getting that suit disposed of in 1897 or thereabouts, it could have been done. The only question involved was the construction of the lease.\* Both sides were controlled by the same authority."

If the suit was sham, then the asserted fact of a single control of both sides is important. Common directors could have allowed a sham suit to drift to im-

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\* In this Mr. Milburn has overlooked the fact that the Central Companies asked, if necessary to obtain its alleged rights, for a reformation of the lease on the basis of voluminous allegations of fact.

mediate decision without reference to proper preparation of the prosecution or of the defense as might best suit their purpose. But the suit was not sham, and there is no proof even tending to show that it was sham. Acting in good faith those charged with the conduct of the suit would proceed exactly as they did proceed, making sure of proper preparation, and of the attendance of witnesses and of the counsel who were subject to the diverse calls usual with counsel of such eminence.

The question of construction involved in that action was exactly the same question that is involved in this action, begun in May, 1900. The tireless energy and capacity of the attorney for the plaintiff in this case is known as well as is his high professional courtesy. No one can doubt that he has desired, and has done everything possible to insure and to effect the prompt and proper trial of this action, which now is submitted for decision—not finally, in the Court of Appeals—but in the first instance, before the Referee in February, 1904, nearly four years after service of the summons. How idle and unreal, then, is all criticism founded on the idea that in this city, at least, actions of this importance or character can be *finally determined* in one year or in three years. Every one familiar with practice in New York knows that in ordinary course an important action such as the Central suit, or the Hitchcock suit, or the present suit, if seriously contested, cannot be tried, and then carried through the Court of Appeals in less than five or six years. If proof be required in addition to that afforded by the history of the present action, it will be found in the report of the committee upon the laws delays in New York, submitted to the Legislature in January, 1904. Mr. Milburn's jaunty statement, "They could have tried that law suit, and had these questions settled if they had wanted to," necessarily, though not intentionally, is offensive, and certainly is unjust, to the counsel charged with the responsibility for the oppos-

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ing interests. No proper trial in any forum could have been had before June, 1898, in view of the diverse engagements of counsel, as to which, of course, Mr. Milburn has no personal knowledge; and no final determination in the Court of Appeals (the only and real determination which could settle the question) could have been had in 1898 or before 1900.

We may dismiss from the category of circumstances the institution, and the character of the Central action, or any imagined delay in its prosecution.

In chronological order, the next transaction is the Central directors' meeting upon June 22, 1898, when, as said by Mr. Milburn, the "matter, having lain in abeyance for a year, is taken up again," almost coincidentally with the sale of the Harlem bonds to the Fisk syndicate on July 29th, 1898.

Mr. Milburn in his flight suggests, though without elaboration, that there had been delay in the trial, and that there was "a curious coincidence of activities "in connection with these proceedings in regard to the "modification of the lease and the bond proceedings."

This light and graceful touch of Mr. Milburn, as often in the course of his argument, deposits a drop of poison. To Mr. Milburn the mere fact of an occurrence in the course of these transactions, in and of itself, seems to be an occasion and warrant for suspicion. But in this special instance, as generally, such suspicion is born of the necessities of the plaintiff's case, and without consideration of existing conditions, which were fully sufficient to account for any supposed coincidence of the Fisk syndicate transaction and the compromise discussion.

As testified by Mr. Banks (pp. 29, 30), conditions suitable for a public offer of the Harlem bonds did not exist until after the enactment of legislation permitting them to be taken by savings banks. Such legislation (being the Act. Chap. 236 of the Laws of 1898) was not passed until April 12, 1898.

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Upon reference to the letter of Messrs. Morgan, accepted by Messrs. Fisk, it will be observed that the transaction was not subject to variation or impairment by reason of any contest or of the continuance of any contest, between the two companies. The accepted offer was to deliver the bonds "when and as the same shall by us be received *from either of the said companies,*" at  $108\frac{1}{2}$  "and accrued interest," which last phrase (as explained by Mr. Banks, p. 24) protected the vendors against any delay by including the interest "from the day when the interest began to run, from May, 1900, up to the time when they were actually taken."

Thus it is clear that the bond sale to Fisk in no wise was dependent upon, or necessarily coincident with, the adoption of the compromise agreement. That agreement had originated at the meeting of the Central Board a month prior to the Fisk sale, and was consummated at the joint meeting of the two committees a fortnight after the Fisk sale, subject to the approval by stockholders to whom the matter was to be submitted two months later.

Upon like consideration of the facts, it will appear clearly also that consideration of the compromise had not been delayed until, or been hastened by, the consummation of the sale to Fisk.

As appears by Article 18 of the stipulation (p. 15), the Central suit in due course appeared for trial on the day calendar on May 16, 1898, when it could have been tried except for the illness of one of the witnesses, and on call the trial was postponed until the October term, 1898. In this there was nothing to suggest fault on either side, nor, as above indicated, was there any fair ground for criticism in the fact that under no possible conditions could the trial of the Central suit be begun before October, 1898. In the presence of this obvious fact it had become perfectly apparent to both sides that the final judicial determination of the great question between the two companies could not be had

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sooner than June or October, 1901, nor until long after the ripening of the respective rights of the two parties to the salvage in dispute. Then the men of affairs in the control of the business of the two companies realized that the judicial determination of this controversy, because of uncertainty both as to its result and as to the possible date of its result, was far less likely to be satisfactory to the stockholders than would be their own adjustment made by themselves of their own dispute.

That such an adjustment by the stockholders of their own dispute would be perfectly fair, was conceded by Mr. Milburn himself, who, in his silent watches first taking up this case for consideration, felt that the stockholders' meeting was the serious question, and asked himself,

"If corporations are situated in this way, and the whole matter is sent to their stock holders, and the stockholders say, 'This thing shall be done,' what is my position? What is the answer? I never believe in blinking the hard question in a case."

Presently we shall consider, and, as we believe, fully refute, the answers proposed by Mr. Milburn. His answers however recognize that in and of itself the submission of the entire question to the stockholders would be a fair, reasonable and honorable disposition of the subject. Such recognition of the advantage of this particular course by the Central directors in June, 1898, coincides with the further conclusion then reached by them, that in the ordinary course of judicial procedure their law suit could not be determined until after May, 1900.

There is no evidence whatever to show, or even to warrant a fair inference, that the directors' action in June or August, 1898, had any relation to the Fisk syndicate contract of July, 1898. Indeed, any reasonable idea of any interdependence or relation between these two events is excluded by the terms of all the documents in the case.

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The fanciful theory of coincidence may be relegated to the limbo of unsubstantial spirits, and now we may proceed to a particular examination of the transactions in the Central board and in the Harlem board in June and August, 1898.

At the meeting of the Central Board, on June 22, 1898, there would have been no quorum present without counting W. K. Vanderbilt, F. W. Vanderbilt and Clarke, who were Harlem directors.

Correspondingly, at the meeting of the Harlem Board there would have been no quorum present without counting W. K. Vanderbilt, F. W. Vanderbilt and S. D. Babcock, who were also Central directors.

Mr. Milburn charges, and no one denies, that the action taken at those meetings could not have been taken without the presence of common directors, and that in each case the resolutions adopted received the support of two common directors present and voting in each of the two boards. Upon this admitted fact Mr. Milburn has commented, but, as it seems to us, without showing consequent invalidity. Already we have asserted, and without hesitation we reiterate that it is the right of common directors to authorize and to make a contract which is perfectly valid at law, and which will be perfectly valid in equity unless seasonably rejected by stockholders. Such right validly to contract or to create a legal liability necessarily includes the lesser right to compose or to adjust any such liability already created, and, beyond any reasonable question, must include the right to submit to stockholders the question whether they will authorize or will ratify a settlement or adjustment of an existing liability. This particular point has been settled beyond possibility of dispute in the cases in the *Appendix*, including *Hodge vs. U. S. Steel Co.*

It is to be observed, further, that at each of these meetings the Directors committed themselves to the

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principle of an amicable adjustment by some division of the interest salvage, and that neither board prescribed the exact division or the exact terms of adjustment. Each board exercised its official power. The Central Board delegated to a committee\* full power to make a settlement, and the Harlem Board appointed a like committee to make a report and agreement, which should be binding upon the Harlem Company when approved by the Harlem stockholders at the meeting called under said resolutions.

Such action of each board became the official and legal basis of the agreement subsequently formulated. But in such action of the two boards there was nothing conflicting with the duty of any director to any stockholder of either company, the formulation of an agreement being delegated to two disinterested committees, with full power, and the operation of the agreement, when formulated, being made to depend upon confirmation by stockholders.

After *six weeks' interval* upon the 10th day of August, 1898, the two committees appointed respectively by the Central Board and by the Harlem Board, met in joint session and adopted the resolutions and approved the second supplementary contract as fully set forth in the record (pp. 224-236).

No member of either committee was a common director, and no Harlem director excepting Mr. Dutcher had any interest in the Central Company. As we have seen already, Mr. Dutcher's Harlem interest was larger than his Central interest. Consequently no Harlem stockholder is entitled to attack any member of either of the two committees because of personal interest or because of his being a common director. These committees, thus personally qualified, possessed

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\* NOTE. At its subsequent meeting, upon August 25, the Central Board formally approved, and thus itself adopted, the action of its committee.

the full powers of the board under the resolutions of their appointment lawfully delegating such power (see *Hoyt vs. Thompson's Executor*; *Olcott vs. Tioga R. R.*; *Sheridan El. L. Co. vs. Chatham Bank*, in *Appendix*). The compromise agreement would be legally sufficient and unassailable at law, though resting solely upon the action of the joint committees.

But here, as ever, we are in pursuit of the truth; and if the forms, though legally unassailable, merely were the cloak and cover for the hidden accomplishment of an unlawful purpose, the Court rightfully and ruthlessly will brush aside and break down all forms upon proof of the existence and accomplishment of such wrong doing. Proof, however, is necessary, and not unjustifiable inference or mere suspicion of that which did not exist.

One fact in connection with the joint meeting of these committees has attracted the comment of Mr. Milburn, and this fact is that at the very opening of the meeting there was presented "the draft of a proposed second supplementary contract which had been prepared as an amendment of the existing lease, and which had been considered by some of the stockholders of both companies as affording a fair and acceptable basis of settlement."

If, as apparently is the fact, Mr. Milburn's criticism is addressed to the fact that during *the six weeks' interval* a contract had been preliminarily drafted for the consideration of the two committees, instead of being postponed until after conclusion of their conference, the criticism would seem to concern solely the method of procedure. It is submitted, without probability of denial by anyone acquainted with the methods of business procedure in these active days, that no intelligent committee permits itself to meet in actual session until after the members separately have considered and have provided for the formulation of its work to such extent as to avoid needless or protracted sessions over matters of mere detail. Here the committees

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were meeting under resolutions which approved an adjustment subject to approval by stockholders. In preparation for the meeting, it would seem, the chairman had occupied *the six weeks' interval* by arranging for the formulation of a corresponding draft agreement for the preliminary consideration of the committees and the stockholders of each company. Such draft agreement, though necessarily somewhat extended, really comprehended only two features, which were fully disclosed to the committees in the following succinct statement of the chairman :

“ The main feature, is the payment and reservation  
“ to the Harlem stockholders of a sum equal to two  
“ per cent. upon their stock, in addition to the rent  
“ already payable under the lease of April 1, 1873, the  
“ Central Company to have the benefit or the burdens  
“ of all decrease or increase of interest payments on  
“ any refunding of the bonds of the Harlem Company.”

No session, however, protracted, could have brought before the minds of the committees more clearly the points at issue and the points covered by the second supplementary contract. The minutes show full consideration of the subject :

“ Some discussion ensued, and after various informal  
“ suggestions and an informal vote, it was generally  
“ agreed that the basis of settlement proposed was  
“ fair, and would be acceptable to the stockholders of  
“ both companies.”

It is believed that in the conduct of committees the experience of the Referee can disclose no fairer or more deliberative procedure.

Having thus fully considered the principle and the document and having accepted the same by informal vote, the committees then proceeded to formal vote. Thereby they approved unanimously of an equitable and final adjustment of the differences between the two companies by the execution, delivery and performance of the second supplementary contract, and also required “ that

“ a copy of these minutes (having attached thereto the  
“ second supplementary contract) signed by the chair-  
“ man and by the secretary, be delivered to each of the  
“ companies as the report of the joint committee.”

Such a copy was signed and delivered by Mr. Callaway (Central president, as chairman) and Mr. Rossiter (Harlem director) as secretary.

This agreement made by the fully authorized agents of each company signed and authenticated by their common agents appointed for that purpose, representing each company, and communicated to the respective companies, constituted an agreement in writing under the Statute of Frauds, if such statute were applicable, under the decision cited in the principal brief (*Argus Co. vs. Mayor of Albany*, 55 N. Y., 495). For its finality, this agreement thus made, lacked only the confirmation of stockholders, for by its terms it was to become operative only upon such ratification. But under the general rules of law such ratification when made would retroact, and would render the contract operative from the date of its original execution. The adoption of a contract subject to such ratification of stockholders is not unknown to the law (*Cook on Corporations*, 4 ed., § 709, citing *Kelsey vs. New England Street Ry.*, 46 Atl., 1059).

This joint action of the Central committee and of the Harlem committee in August, 1898, resulted in a complete and lawful contract, against which there has been no proof nor any substantial suggestion in any wise tending to show that the transaction was in any degree lacking in perfect good faith.

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In the order of events, we come now to the consideration of the notice, that, under date of September 1, Mr. Cornelius Vanderbilt caused to be issued to the 770 Harlem stockholders, and that may be examined best in connection with the proceedings of the meeting.

**THIRD. As to the stockholders' meeting.**

Little argument is needed to demonstrate the fairness of a submission of the entire question to meetings of the stockholders of the two companies, and its abundant effect to dispel all suggested taint of directors' bad faith in dealing with stockholders' interests.

So much indeed was recognized by Mr. Milburn, but he seeks to nullify the vital and invigorating force of the stockholders' votes upon specific grounds which we shall examine in detail.

Unless his grounds are well taken, the second supplementary contract must be held to be valid because of the stockholders' votes upon October 5, 1898. *And even though every one of his grounds were to be regarded as well taken, the effect would be only to challenge the binding quality of that vote.* Still there would remain the incontrovertible evidence of good faith afforded by the very fact of submission of the question to all the stockholders.

No Board of Directors acting in bad faith to its stockholders could have submitted to them the question in the way that this was submitted.

As shown by the result the submission was fully sufficient to give timely notice of the real condition to every stockholder who desired to dissent or to litigate. Neither Mr. Charles E. Miller nor Mr. William Starr Miller, nor any stockholder represented by Mr. Trull or by Mr. Collin can have lacked sufficient information, for at the meeting they were all present or represented and opposed the compromise.

That to any other stockholder the notice conveyed less information than it did to these there is no proof; and convincing proof to the contrary is shown by the acquiescence and acceptance of over 96 per cent. of the stockholders owning over 94 per cent. of the stock for more than five years, and after five annual meetings of stockholders.

Therefore, we argue (1) that the mere fact of this submission to stockholders, dispels every suggestion of directors' bad faith, and (2) that, of Mr. Milburn's objections to the mode of submission, not one is well taken, as now we may proceed to show :

(a) *As to the objection that the stockholders' meeting was but part of a general scheme of fraud.*

This objection cannot survive examination.

The submission to stockholders is an element so absolutely fair, that if it originally had been part of a preconceived plan, *that would prove that the entire plan was fairly intended.* It is impossible to conceive that a conspiracy of darkness was the original purpose of those who always intended to bring their proposal into the broad light of day, and to submit it for acceptance or rejection by those to whom they were responsible. So we say that if it be true that from the beginning "it was part of the machinery, "the whole transaction, that there should be a stockholders' meeting," then from the very beginning the whole transaction was animated with a fair intent.

If, as Mr. Milburn argued, "the stockholders' meeting was a wheel, one of the wheels of the whole thing," it was the giant driver which imparted motion, and which for its own action depended not upon any other wheel, but directly upon the vital force of the will of the majority.

(b) *As to the objection that the question was not presented fairly for the stockholders.*

This objection was based upon ~~six~~ distinct propositions (see p. 68 *ante*), of which each easily may be shown to be unsound.

(1) The fact of common directors needed no special presentation.

The Vanderbilt common direction in the Vanderbilt roads is and was a matter of common knowledge (as

Mr. Milburn himself has argued), and presumably was not unknown to any stockholder in the Harlem Company, whose road for 25 years had been operated, and whose dividends for 25 years had been paid, by the Central Company, a name which connoted the name of Commodore Cornelius Vanderbilt.

As matter of law, the appeal to stockholders in itself declared that the directors deemed the question to be one upon which they should not take final action, for, as recognized by Mr. Milburn, the directors themselves could have made a compromise, except for the fact that there were many common directors.

In *Grant vs. United Kingdom Co.* (Appendix civ.), all the judges agreed on the following proposition :

*"It was argued that the meeting was not good because the notice convening it, gave no intimation that the contract was one which could not be carried into effect, without the sanction of a general meeting. I think that the difficulty was sufficiently suggested by the mere fact of a meeting being called, for had it not been for the fact that the directors were interested, no meeting would have been necessary."*

(2) There is no substance in the objection that the stockholders were not reminded that the Harlem Company had resources, property and credit, out of which it could have paid off the consols, thus obtaining the benefit of the entire interest salvage.

*First.* Already the stockholders (including Hitchcock and the plaintiff) had finally adopted the proposition to refund the consols; and the refunding mortgage had been made and publicly recorded, thus releasing to the stockholders for present enjoyment the outside cash assets, which thereafter were paid to, and were received and retained by, each and every stockholder September 19th, 1899 (page 23). *Second.* Under the original lease the Harlem Company had absolutely covenanted not to make or issue any stock or any bonds of any descrip-

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tion whatever (Complaint, p. 33); although for the sole purpose of *operating* the street railroad the Central Company might abate this covenant of the Harlem Company. In supposing that the Harlem Company was free to issue debentures or unsecured bonds, Mr. Milburn was in error. *The covenant was against any bonds whatever.* Therefore the Harlem Company had absolutely no borrowing capacity, and consequently no credit resource out of which to pay the consols. *Third.* The annual rentals receivable from the Central Company and the Metropolitan Company would not in any one year equal, nor by May 1, 1900, would they equal, the \$12,000,000 required to pay off the consols, not even though to such rentals had been added all outside resources. There is absolutely no substance to this suggestion of Mr. Milburn, which clearly was an afterthought, inconsistent with the entire theory of the complaint, and a counsel of desperation.\*

(3) The proposed compromise was not a *simulacrum*, and it was eminently proper for Mr. Cornelius Vanderbilt to put it forth as a real thing, and to recommend it.

Cornelius Vanderbilt believed in the advice of his counsel Henry H. Anderson, and he believed in this adjustment of the controversy. With no personal advantage therefrom which would not accrue ratably to every stockholder, and (if the plaintiffs' theory be sound) with the greatest loss therefrom, Mr. Vanderbilt had concluded to cast his impressive vote in favor of the second supplementary contract. Doing this because he believed it to be right and to be for his interest *as a Harlem stockholder*, he acted the part of the man and trusted leader

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\*NOTE—Furthermore it is clear that such a diversion of annual rentals to the payment of a principal debt, would have involved for a long period a suspension of dividends upon the Harlem stock, which, as Mr. Milburn correctly stated, was an investment stock. It was bought and held largely by individuals, who relied upon the regularity of the dividends; and of whom doubtless many depended upon such regular dividends for at least a portion of their living expenses.

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that he was, and commended to his stockholders the course which he had approved for himself. It was such consistency of conduct that won for him the general commendation of his fellow men and fellow-stockholders. His course was not only right but honorable. His stockholders were accustomed to ask and to receive his advice, and those who received and who acted upon it in the present case have not signified their desire to retract.

Those who received and rejected the advice, of course, were not themselves injured thereby. The pretense that they were injured because the majority were misled is supported by no proof, but is refuted by all the conditions.

In absence of direct proof that the majority did not understand the proposition for which they voted (and which for years they continued to ratify), it should be assumed that they did understand it.

Conversely, if the record is the exclusive source of knowledge, it would follow that the plaintiff and Thomas Hitchcock had only such information as by the record is shown to have been the possession of every stockholder. Their conduct proves that such information was sufficient to advise every stockholder (1) of his position, (2) of the manner and extent to which the same might be affected, and (3) of his opportunity to assert himself, either by adverse vote or by hostile litigation. What further or larger information was needed by the majority? It was adequate for plaintiff and Hitchcock, who have in the evidence no basis for imputing to the majority an inferior capacity to comprehend. The long continued approval of the majority by vote and by years of express ratification, under the stated conditions absolutely negatives Mr. Milburn's plea that the majority did not fully understand the proposition for which the majority voted.

(4) It was proper to submit, not merely the question whether there should be a compromise, but also a complete though contingent agreement of compromise.

Detailed information additional to that given by the circular notice through the previous formulation of a new and precise agreement was a proper and suitable aid for those who might desire such detailed information, as was recognized by Judge VAN BRUNT in the *Metropolitan Ry. case* (Appendix viii.) in the following language :

“ If the directors have no power to lease without the assent of the shareholders, such shareholders might determine the terms and conditions of the lease to be given. *If their consent is necessary, it must be because they are to be consulted as to the advisability and desirability of leasing their property, and that question depends almost always upon the terms and conditions of the lease proposed. Therefore, how can they intelligibly act unless they know what is to be done? They might give their assent to a lease upon certain terms, and refuse it upon other conditions.* The stockholders could, if they chose, give a power to lease to their directors, leaving the latter to determine the terms and conditions ; but that was not done in respect to the agreements and leases of May 20th, 1879. The stockholders approved of these instruments after they were executed and after they had been read and considered. They consented to lease upon those terms and no other.”

The submission of the question of compromise in the form of a complete though contingent agreement, therefore, was an aid and was not a hindrance to the stockholders. So also was the information concerning the director's proceedings, out of which the agreement had issued. These proceedings were pertinent facts for consideration by stockholders, and had knowledge thereof been withheld from them, the charge then made very properly would be a charge of willful suppression.

No objection is taken to the *mode* in which the lease was communicated to the stockholders, the mode being that which was sustained in *Hodge v. U. S. Steel* (Appendix, lix.).

The directors properly took this method of informing every stockholder desiring information as to

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details instead of making an advance broadcast distribution of more than 13,000 copies among the more than 13,000 stockholders of the two companies.

(5) The compromise was adopted by more than an absolute lawful majority of the entire Harlem stock; and by more than a majority of all the stock whether present or absent and not challenged by plaintiff.

For reasons and upon authority abundantly presented in our principal argument, every stockholder had an absolute right to vote at this meeting, regardless of his interest (*Burland vs. Earle*, Appendix, p. lii.; *Transportation Co. vs. Beatty*; *Gamble vs. Queens County Waterworks*, xxxv.; *Bjorngaard vs. Goodhue*, lxxxiii.; *Hodge vs. U. S. Steel*, iv.; *Socorro Company vs. Preston*, cvi.; *Windmuller Cases*, cxvii., cxxii.)

*But, though every challenged vote were excluded, still there would remain an unchallenged majority of the total unchallenged vote.*

Mr. Milburn has failed to observe that, if because disqualified by reason of personal interest in the transaction, the shares owned by the syndicate subscribers or the Central directors or stockholders, were not entitled to vote, it follows logically that the shares so disqualified must be excluded from any consideration whatever. These challenged shares either were, or were not, disqualified from voting. For the purposes of this canvass, any disqualified share, whether voted or not voted, is the same as though non-existent. Yet, according to the argument of Mr. Milburn, shares owned by the syndicate subscribers or by the Central directors or stockholders and, in his view not qualified, to vote for the proposition, are effectually to be treated and counted as though they had been present, and had voted against the proposition. For, by his assertion that after excluding from the affirmative vote such disqualified shares, the residue of affirmative votes constituted less

than a majority of the total shares, Mr. Milburn in effect turned all the alleged disqualified affirmative votes into qualified negative votes. This method obviously is as untenable as it is unjust. The only logical method would be to exclude the alleged disqualified shares, if at all, for all purposes, whether for or against the proposition, and then to ascertain the result by a canvass of the votes of the remaining unchallenged stock.

Except when shown to be otherwise, as in the case of the 5774 shares owned by the plaintiffs who did not vote at all (Art. 36), all non-voting stockholders are to be regarded as having favored the compromise, especially when they have accepted payment under the compromise (see *Rankin vs. Newark Library Assn.*, 64 N. J. Law, 265 ; App., cviii.).

As already pointed out in the principal argument (*ante*, pp. 21-24), there is no method of reasonable calculation which does not show that the compromise has been favored by a clear and positive majority (84/116) of the unchallenged stock, whether voting or not voting ; and by nearly three-fourths (146/200) of the total stock.

Finally, it is to be considered that though an actual majority had not been voted for the compromise, nay, more, *if a majority at the meeting had voted against the compromise*, nevertheless, the compromise would still be legally binding. This statement, though not necessary to support the compromise, is perfectly sound in law and in morals, because since the beginning of this action, and after three annual meetings, 97 per cent. of the stockholders holding 94 per cent. of the stock with full knowledge of the compromise, have elected to ratify the agreement by accepting and by retaining the regular semi-annual payments from the Central company under the compromise. Such a ratification or the possibility of such a ratification *pendente lite* causes a Chancellor to stay his hand from interfering with the discretionary powers of the majority stockholders

(*Foss vs. Harbottle*, 2 Hare, 465 ; *Burland vs. Earle*, liii. ; *Phosphate of Lime Co. vs. Green*, ex., Appendix).

Here there was and is neither fraud, nor oppression nor illegality ; *nor is any imputed to the vast majority of these stockholders* who, declining to litigate, and choosing to avoid uncertainty and exercising their clear right of property are pursuing the general policy of the law, "*ut sit finis litium*."

Except at its own option the Central Company is entitled to all possible benefit, at the risk of any possible loss, by opening for judicial determination, in a suit of this character, *the question as to the entire salvage*. The Central Company is not bound to recognize the compromise in a suit in behalf of the Harlem Company that attacks the compromise

(6) There is no proof that the pendency of the Hitchcock suit was unknown to any stockholder, but even if such be the fact, it is an immaterial fact.

The refusal of the holders of less than 6 per cent. of the stock to agree with the holders of 94 per cent., and even the fact that some of the malcontents had brought suit were not facts that required the Directors to ask the 94 per cent. to reconsider their vote.

The fact of the Hitchcock suit and its settlement were all entered on the Harlem Directors minutes (pp. 477, 495, 499), and were matters of such importance that in absence of evidence to the contrary it is fair to assume that they were known to 97 per cent. of the stockholders who accepted payment of increased dividends with express notice of their source. "If any of the stockholders did not have knowledge, \* \* \* it was not because anything was concealed from them. They had the means of knowledge within reach ; and the possession of such means of knowledge, is in equity the same as knowledge itself, *City of New Albany vs. Burke*, 11 Wall, 96" (*Calivada Colonization Co. vs. Hays*, 119 Fed., 202-208).

The Harlem Company held annual meetings (p. 89: Laws 1831, Ch. 263, § 6). Since April, 1900, there have been three annual meetings, at any one of which the plaintiff could have appealed to the stockholders on the grounds alleged in any one of these suits, and could have made them known to any stockholders who were ignorant thereof.

We do not, however, concede it to be of the slightest consequence as to any issue in this case, whether at the time of the stockholders' meeting in October, 1898, or at any later time, the Harlem stockholders did or did not know the facts with regard to the beginning or the defense or the settlement of the Hitchcock suit. Every Harlem stockholder was fully apprised by Cornelius Vanderbilt's circular notice of every material fact bearing on the situation as to the propriety or desirability of the compromise agreement. Every Harlem stockholder had been informed as fully, and knew as much about the matter, as did Thomas Hitchcock. The circumstance that Mr. Hitchcock chose to litigate, while other stockholders did not so choose, had no bearing whatever on the merits of the compromise. The Hitchcock complaint alleged no facts that were not generally within the knowledge of the Harlem stockholders, or that were not fairly communicated by the circular to each and all of them (see *Phosphate of Lime Co. vs. Green*, Appendix cx).

#### **FOURTH. As to the unfairness of the agreement.**

Mr. Milburn asks the Court to look into the fairness of the contract, referring to the *Gamble* case, where he said, "the Court looked into the transaction to see "whether it was a fair and equitable one."

This is a misapprehension of the *Gamble* case, where the Court looked into the transaction not to as-

certain its *fairness*, but to determine a question of law, viz., whether director Gamble had sold the works to his company at a price so excessive as to justify the inference of *actual fraud* drawn by the General Term from certain findings to which Mullins had excepted as being unsupported by evidence (p. 100). Upon this question of law, the Court proceeded to search for evidence not of simple unfairness but of actual fraud, and it concluded its examination by the statement that fraud had not been shown (p. 105).

But, already (p. 99), the Court had laid down the rule which generally must govern such cases and which now is plainly applicable as follows :

“Generally, the rule must be that in such cases the will of the majority shall govern. The Court would not be justified in interfering even in doubtful cases where the action of the majority might be susceptible of different constructions. To warrant the interposition of the Court in favor of the minority stockholders in a corporation or joint stock association as against the contemplated action of the majority, where such action is within the corporate powers *a case must be made out which plainly shows that such action is so far opposed to the true interests of the corporation itself as to lead to the clear inference that no one thus acting could have been influenced by an honest desire to secure such interest, but that he must have acted with the intent to subserve some outside purpose regardless of the consequences to the company and in a manner inconsistent with its interests.*”

Under this rule, not one of Mr. Milburn's objections to the compromise would be of consequence, for the compromise was voted by stockholders who were in doubt whether the company would not suffer a loss, and who desired to make it impossible for the company to suffer a loss amounting not only to the partial extent indicated by Mr. Milburn, but possibly to the entire salvage. It was their right to determine, and they did determine, how much of the possible gain the Harlem Company might best concede to make sure of a certain gain. No one can say even now that they acted against

Harlem interests so certainly "*as to lead to the clear inference that no one thus acting could have been influenced by any honest desire to secure such interest.*"

Nothing less will answer Mr. Milburn's purpose:

Mr. Milburn's attack upon the fairness of the agreement, of course, is an attack upon the validity of the act of the overwhelming majority who were stupid enough not to take the plaintiff's view as to the Harlem interests. But as was acutely observed by Judge VAN SYCKEL in the *Hodge* case (Appendix, lix.), the majority certainly owed no more duty to the minority to take its view, than did the minority to take the view of the majority. The right of the majority to adopt and to enforce a policy according to its own view is a property right attaching to the ownership of a majority of the stock. As often happens, the vital distinction has been pointed out best by Sir GEORGE JESSEL, who said in *Pender vs. Lushington* (6 Ch. Div., 70):

"I cannot deprive him of his property, though he may not make use of the property in the way I approve. This is really the question, because, if these stockholders have a right of property, then I think all the arguments which have been addressed to me as to the motives which induced them to exercise it, are entirely beside the question."

Then (after referring to a decision by MELLISH) the Master of the Rolls proceeded:

"In other words, he [MELLISH, J.] admits a man may be actuated in giving his vote as stockholder by interests adverse to the interests of the company as a whole. He may think it was for his particular interest that a certain course may be taken which may be, in the opinion of others, adverse to the interests of the company as a whole; but he cannot be restrained from giving his vote in what way he pleases, because he is influenced by that motive. There is, if I may so say, no obligation on a shareholder of a company to give his vote merely with a view to what other people may consider the interests of the company at large. He has a right, if he

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“thinks fit, to give his vote from motives or promptings of what he considers his own individual interests. This being so, the arguments which have been addressed to me, as to whether or not the votes which were given would bring about the ruin of the company, or whether or not the motive was an improper one which induced these gentlemen to give their votes, or whether or not their conduct shows a want of appreciation of the principles on which this company was founded appear to me to be wholly immaterial.”

The doctrine that in such cases the property rights of the company are to be administered according to the will of the majority of the stockholders, not of the Chancellor, has been last stated as follows in the case of *Shaw vs. Davis* (Appendix, lxxxiii.):

“If the proposed lease be not *ultra vires* or unlawful or fraudulent, no court, at the instance of a minority stockholder, or at the instance of any one else, has the power or the right to restrain the majority from dealing with the property as they may deem most advantageous to their own interests. Any other doctrine would put it in the power of a single stockholder, owning but one share out of many hundreds, to transfer the entire management of a corporation to a court of equity, and would effectually destroy the right of the owners of the property to lawfully control it themselves. It would make a court of equity practically the guardian, so to speak, of such a corporation, and would substitute the chancellor’s belief as to what contracts a corporation ought, as a matter of expediency, or policy, or business venture, to make, instead of allowing such questions to be settled by the persons beneficially interested in the property. No such arbitrary or dangerous power has ever been claimed by any court, and, if laid claim to, it would never be tolerated in a free government. The injunction granted on March 14, 1891, prohibited the making of a lease upon the terms of 60 per cent. of the gross earnings, or any other lease, until the further order of the court.

\* \* \* \* \*

“As the court had no power to decree a lease, so it had no power to prescribe the terms of one.

“ It could prohibit the doing of an act *ultra vires*, illegal, or fraudulent. Beyond that it could not go. As no such act was before it, it did right in dissolving the injunction, and in dismissing the bill. For the reasons we have given we will affirm the decree appealed from. Decree affirmed, with costs above and below.”

Under this general rule that the Courts have nothing to do with the internal management of corporations not amounting to actual fraud, wanton waste or illegality, is it not clear that the three particulars to which Mr. Milburn asks attention (see p. 69, *ante*) are not such as to justify judicial interference with the Harlem stockholders' determination as to what was best for the Harlem Company ?

The attack now made upon the fairness of the compromise in these three particulars, virtually, though not expressly, concedes, that otherwise the attack has failed. These three particular points really are three counts upon one indictment of the Harlem majority for having conceded to the Central more than they should have conceded, even though a compromise was to be made. But, surely, if, as we believe we have demonstrated, the difference between the two companies was a proper matter for bargain, the terms of the bargain were for negotiation by the parties and not by the Courts. As was said by the New Jersey Court of Errors in *Berger vs. U. S. Steel* (Appendix lviii.) :

“ 2d. The manner in which a duly authorized plan is to be carried through is part of the business of the corporation, and in the absence of fraud or bad faith, is not the subject of judicial control to any greater extent than other business of the corporation. *The Court cannot substitute its judgment for that of the directors and majority stockholders, and say that a less expensive plan could be successfully adopted.*”

Were this otherwise, the three points criticised by Mr. Milburn are points concerning which men might honestly first differ and afterwards agree.

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(1) An exact division of the \$420,000 annual interest salvage would have been \$210,000. The actual allowance to the Harlem was \$200,000, or \$10,000 less than one-half of the total salvage; (not \$20,000 less, as at least is suggested by Mr. Milburn). The annual sum conceded to the Harlem was two per cent. on its stock. One-half of the total interest salvage would have been two and one-tenth of one per cent. making the semi-annual payments one and one-twentieth of one per cent., an awkward sum. The circular called attention to this difference, and explained its reason. Upon such full explanation the stockholders approved this unequal division. This inequality in distribution of possible revenue amounts to an annual loss of only 5 cents for each Harlem share and an annual gain of only 1 cent for each Central share. To find therein the basis of a charge of bad faith requires the use of a moral microscope.\*

(2) The other two specifications are of matters which cannot develop before the year 2000, when, it is to be hoped, every actor in this controversy will be in a state of blessedness beyond disturbance by any question as to the refunding of the new bonds. Is it conceivable that in making such a final adjustment of all matters under the lease, any present actor was influenced by a fraudulent desire to give to the Central Company an unfair advantage after the end of one hundred years? If the former specification of fraud involved the use of microscope, this one calls for a telescope.

In assailing the compromise in its entire scope the plaintiff has given battle on a large scale. If that has been lost, its fortune of war is not to be recovered by attack on these three minor positions.

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\* NOTE.—Mr. Trull computes that an aggregate loss of \$20,000 for 350 years equals \$7,000,000. But, as already observed, the annual loss would be only \$10,000, reducing his aggregate one-half. Mr. Trull's efforts to carry conviction by presenting aggregations covering periods transcending human experience suggest the fortunes that theoretically, but never actually, are accumulated by investing every day the price of one cigar or of some similar minor indulgence; or the cost of the thirty-second nail in the horse's shoe, the charge being one barley corn for the first nail and doubling with each successor (*James vs. Morgan*, 1 Lev. 111, cited 2 Lord RAYMOND, 1165). If the lease were *in perpetuity*, and not merely for 350 years, Mr. Trull's basis of computation would wholly disappear.

It may be observed, however, that in the complaint (Article XX.) the plaintiff has charged as a vice of the second supplementary contract a provision (Article Sixth, p. 231) which is exactly that of Article Fifth of the original lease (Complaint, folio 97): that the new Article Fifth constitutes a new restriction only so far as concerns the refunding of the new \$12,000,000 bonds; that for all time the compromise has secured to the Harlem \$200,000 annually in consideration of a similar perpetual annual concession of \$220,000 to the Central Company; and that the only question under the last two specifications is as to a possible further salvage through raising or investing (as the case may be) \$12,000,000 on terms better than  $3\frac{1}{2}$  per cent.

This question involves such a speculation as to the rate of money in 2000 A. D., as to transcend the scope of judicial inquiry, and asks the Referee to find that this provision finally settling this and all questions under the lease was inserted not for such purpose of final settlement, but to grab this possible inconsiderable gain of the far distant future.

The bitterness of counsel's grief and complaint over this wrong to posterity has its prototype only in Mark Twain's grief on visiting the grave of his ancestor Adam. If these are the only wrongs suffered by plaintiff, no case has been presented calling for a reversal of the sensible present day judgment of the vast majority of the Harlem stockholders.

#### **FIFTH. As to the bond transactions.**

Upon this point Mr. Milburn has been so vague, frankly admitting his inability to formulate any charge, and the Referee has so clearly indicated his opinion that the bond transactions are immaterial that we see no reason to add anything to the discussion of the point in our principal brief (*ante*, pp. 18-21)-29-34-

**SIXTH. As to the transactions subsequent to the stockholders' meeting.**

The settlement of the Hitchcock suit, and the indemnity on April 4th, 1900, are matters fully discussed and justified in our principal brief (*ante*, pp. 51-59).

The compromise having been actually agreed to by everybody before November, 1898, and having, as we contend, then become legally binding, *these subsequent transactions would* have no retroactive effect unless (as we are sure they do not) they throw upon the prior transactions a light revealing a prior fraudulent purpose. On this point the decisions are clear.

A similar charge in the *Metropolitan case* was thus treated by Judge VAN BRUNT:

"The conduct of the Metropolitan directors, after the making of the October agreements, is claimed to be strong evidence of the fraudulent intent and bad faith with which these agreements were made. That the procuring of the judgment in the People's suit and also in the Superior Court, the adoption of the merger agreement of November 14th, and its terms, and the manner in which dividends were declared, was an attempt to use the forms of law to coerce the stockholders of the Metropolitan and New York companies into a ratification of the merger agreement is to my mind certainly apparent, but these facts are not sufficient to establish an original fraudulent intent.

"*In order that a fraudulent intent in the original act may be deduced from subsequent acts they must be inconsistent with anything but a fraudulent intent originally, and not relate to any subsequent fraudulent intent; because a fraudulent intent formed after an agreement has been executed and delivered, although formed for the purpose of aiding the carrying into effect the terms of the agreement, cannot relate back to the original agreement.*

"Great opposition to the October and November agreements had been manifested by some of the stockholders, and the endeavor was made to crush out this opposition, but these efforts by no means

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“implied that any improper purpose was indulged  
“in at the time of the making of the agreements them-  
“selves.”

This is in harmony with the opinion of the Court in *Hardmann vs. Bowen* (39 N. Y., 196-200) :

“If the assignment was valid in creation, having  
“been honestly and properly executed and delivered,  
“no subsequent illegal acts, either of omission or com-  
“mission, can in any manner invalidate it.”

Settlements of actions such as the Hitchcock suit are entirely legitimate, and stockholders desiring to prevent such settlement should make themselves parties to the litigation (*Cook on Corporations*, § 748; *Hirshfeld vs. Fitzgerald*, 157 N. Y., 166).

Finally, it should be observed that these *acts of the directors* with regard to the Hitchcock compromise and the indemnity not only have no legal effect *retroactively* so as to impair the compromise agreement theretofore adopted by stockholders—even though in some undefined way such acts *per se* might indicate bad faith at the time when done—but *a fortiori* such acts of directors cannot impair the effect of the *subsequent ratification* by the stockholders in receiving their dividends under the compromise agreement. <sup>See pp 63-5</sup> As heretofore we have pointed out, this subsequent ratification of the stockholders would of itself operate to bind the corporation even though there had been no effective vote at the stockholders' meeting, and no subsequent act by the directors.

Having considered and as we believe having answered every point suggested by Mr. Milburn, we respectfully submit that upon the case as finally presented, the

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charges against the directors are unfounded, and being unfounded, "*they are entitled to the benefit of a vindication*" (see 34 Fed. Rep., 179); and the defendants are entitled to judgment dismissing the complaint upon the merits.

February 9, 1904.

WILLIAM B. HORNBLOWER.

FRANCIS LYNDE STETSON.

FRANK LOOMIS.

HENRY B. ANDERSON.



## APPENDIX.

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**Metropolitan Elevated Ry. Co. v. Manhattan Elevated Ry. Co.**

N. Y. Common Pleas, Special Term : April, 1884.]

[The following extended extracts from this elaborate opinion, covering 155 printed pages, contain all of the parts of the opinion that seem material to the present case. The omitted parts concern principally (*a*) the point as to the directors' power to lease, which, though denied by Judge VAN BRUNT, was sustained in the *Beveridge* case (112 N. Y. 1), and (*b*) the point that the action of boards containing common directors was voidable irrespective of the fact that such directors did not actually attend the meeting or participate in the vote. As observed by Judge VAN BRUNT himself (*Beers v. N. Y. Life Ins. Co.* 66 Hun, 85 ; *Nathan v. Whitehill*, 67 Hun, 399), this theory "seems to have been exploded by the decision " of the Court of Appeals in the case of *Gamble v. Queens Co. Water Works Co.* (123 N. Y. 91)." Otherwise, the opinion has been unchallenged, and, as stated by Judge DALY at the close of the case, was accepted as a correct exposition of the law. Its unique parallelism to the present case justifies careful consideration of this opinion of the present Presiding Justice of the Appellate Division in the First Department.]

VAN BRUNT, J.—[After stating the facts.]—

This action is brought by the Metropolitan Railway Company, to set aside the agreements of October 22d, 1881, upon the following grounds :

1st. Because the Metropolitan directors had no power to modify the original leases and tripartite agreement of May 30th, 1879, without the consent of the shareholders.

2d. Because three of the Metropolitan directors were, at the time of the making of the October agreements, also directors of the Manhattan company—one of the contracting parties, whose interests were antagonistic to those of the Metropolitan company.

3d. Because the personal interests of several of the Metropolitan directors were opposed to those of that company.

4th. Because of the actual fraud upon the part of certain Metropolitan directors, who entered into a scheme to benefit themselves at the expense of their corporation.

The defendants admit that the October agreements were not assented to by the stockholders of the Metropolitan company, and claim that such assent was not at all necessary to the validity of the contract. They further admit that three of the Metropolitan directors were also, at the time of the making of the October agreements, directors of the Manhattan company, but they deny that this circumstance in any way invalidated the action taken. They deny that the personal interests of any of the Metropolitan directors were opposed to those of that company; and they also deny that there was any actual fraud; and aver that the agreements of October, 1881, were for the best interests of all the parties concerned, and that they presented the only solution of the difficulties and embarrassments which surrounded the elevated railway system, in the summer and fall of 1881.

The next preliminary objection is, that the October agreements have never been disaffirmed by the stockholders of the Metropolitan company in any way, nor even by the directors, by any direct vote.

If the directors had no authority to make the October agreements without the consent of the stockholders, then certainly no expression of dissent was necessary by the stockholders, because the agreements were void unless ratified by the stockholders, or con-

firmed by action upon the part of the stockholders which amounted to ratification.

*But if it is sought to set aside these agreements because of the fraud, either actual or constructive, then the contract is a voidable one, and due diligence must be used in electing to avoid it. What constitutes due diligence necessarily depends upon the facts of each particular case.*

\* \* \* \* \*

It is now necessary to consider the grounds upon which the plaintiff claims relief.

The questions of law involved are of the greatest importance to the community at large, to the innumerable trading corporations with which our country is filled, and to such of our citizens as hold the shares of stock of such corporations. The respective rights, duties and obligations of both directors and shareholders in these corporations must be determined, unaided by any authoritative adjudications in our own state upon the subject.

Before, however, considering the legal questions presented, I shall endeavor to dispose of the only question of fact presented by the evidence, which bears, in any degree, upon the right of the plaintiff to relief; and that is:

Was there any actual fraud upon the part of the Metropolitan directors; and did they enter into a scheme to benefit themselves at the expense of their corporation?

Upon the evidence in this case, I am clearly of the opinion that no charge of fraud can be sustained. In view of the elaborate arguments which have been advanced by the counsel for the plaintiff in this case, in support of an affirmative answer to this question, and their evident belief that they have established their right to such answer, it is necessary that I should consider the various points raised by them, somewhat in detail.

*Upon an examination of the evidence in this case, and the arguments of counsel thereon, I have had forced upon my mind the conclusion, that their belief in the verity of their position was brought about by asking them-*

*selves the question : " Can any good thing come out of Nazareth ? " by imputing bad motives when the moving cause may have been good ; by considering past transactions by the light and knowledge which subsequent events have developed ; by taking that view of the future of these properties, whether supported most strongly by the evidence or not, which best accords with their desires, rather than by according to the defendants the right of a different judgment which they might in good faith entertain, than by placing themselves in the position of the defendants with no knowledge of the future, than by imputing good motives and meeting the question with the idea that the directors of the Metropolitan company intended to do their duty by that corporation.*

\* \* \* \* \*

It may be said that Mr. Field, who was also interested in the Manhattan company, carried this settlement through the New York board. He undoubtedly urged it ; but that the other directors were under his influence, or that they subserved any other purpose than the interest of their company, is not by any means shown, but upon the contrary, the evidence shows that the proposition was vigorously canvassed and finally approved as the best solution of existing controversies, by men unbiased by any adverse interest.

*Much has been said about that bugbear of the \$13,000,000 claim. This claim may have no foundation ; it may be frivolous. As to this, I do not express any opinion, but respectable counsel had given it their sanction and it was a good thing to get it out of the way. It might have given trouble when least expected, and that it had no foundation in law, in the opinion of the eminent counsel for the plaintiff, does not alter the fact that it was very desirable to dispose of it if possible.*

I have had brought under my notice a case which illustrates how dangerous it is to leave outstanding a claim which is declared without foundation by the most eminent counsel.

Not very many years ago, a suit was to be begun to have actual partition of certain real estate in this city, amongst the numerous tenants in common. It

being a very important action, and as it would involve the title to a very large and valuable property, the most eminent counsel then at the New York bar was retained to supervise the proceeding. During the preparation of the complaint, a question arose as to whether it would not be desirable to make a person, who had been appointed as assignee in bankruptcy in 1841 of a party through whom an interest in the property descended, a party, to save all question. The attorneys favored it, although they were of the opinion that such assignee had no interest, upon the ground that it was best to make any or everybody a party in a partition suit, who not only could have or by the slightest possibility could claim to have, any interest; the eminent counsel examined the question and was firmly convinced that any claim by the assignee would be of the most frivolous character, and the attorneys pressing the view that it was best anyhow to make this assignee a party, to save all question, the eminent counsel declared that he would retire from the case if any such unnecessary parties were made defendants. The assignee in bankruptcy was not made a party. The action went on, the property was partitioned, a large amount of it sold, title taken, upon the eminent counsel's opinion as to the regularity of the proceedings. Some time afterwards the Court of Appeals decided that by the assignment in bankruptcy in 1841, the whole title to that share in the real estate, claimed through the bankrupt, had passed to the assignee, and, as a result, the title to the whole of the property partitioned was defective.

*I therefore say, that no matter what any lawyer's opinion may be as to the invalidity of a claim of the character of the \$13,000,000 claim, no matter how frivolous in the opinion of some it may be, it is no evidence of fraud that its existence was recognized in this settlement.* That this claim, of itself, was the moving cause of the reduction in the rentals to be paid to the companies by the Manhattan, cannot, I think, with verity be asserted; or that it was a very potent factor in determining the terms of the new arrangement; but that it was

thought advisable to get rid of that claim, and that it was taken into consideration with the many other things necessary to a determination as to the advisability of any particular action, is undoubtedly true.

\* \* \* \* \*

The conduct of the Metropolitan directors, after the making of the October agreements, is claimed to be strong evidence of the fraudulent intent and bad faith with which these agreements were made. That the procuring of the judgment in the People's suit and also in the Superior Court, the adoption of the merger agreement of November 14th, and its terms, and the manner in which dividends were declared, was an attempt to use the forms of law to coerce the stockholders of the Metropolitan and New York companies into a ratification of the merger agreement is to my mind certainly apparent, but these facts are not sufficient to establish an original fraudulent intent.

*In order that a fraudulent intent in the original act may be deduced from subsequent acts they must be inconsistent with anything but a fraudulent intent originally, and not relate to any subsequent fraudulent intent; because a fraudulent intent formed after an agreement has been executed and delivered, although formed for the purpose of aiding the carrying into effect the terms of the agreement, cannot relate back to the original agreement.*

Great opposition to the October and November agreements had been manifested by some of the stockholders, and the endeavor was made to crush out this opposition, but these efforts by no means implied that any improper purpose was indulged in at the time of the making of the agreements themselves.

The absence of Mr. Connor, and the non-production of the books, are to my mind a very suspicious circumstance; and were it not for the rule laid down in *Bleecker v. Johnston* (69 N. Y. 309), I should necessarily conclude that their absence justified the strongest inference to be indulged in against the defendants. But as this rule is held by the court, in that case, only to apply to cases where it is shown that a party

has resorted to improper means to get or keep witnesses away from the trial, my own opinion must conform. *Although we may imagine a great many things in connection with this matter, yet unless our deductions are supported by some evidence, they cannot form the foundation of a legal judgment.*

There are other minor points which have been urged by counsel upon this question; but this opinion has already grown to such an inordinate length, that I am warned to take up no more time or space in the discussion of this point.

The next question to be considered is—

Had the Metropolitan directors the power to modify the original leases and tripartite agreement of May 20th, 1879, without the consent of the shareholders?

In the disposition of this important question, I am but little aided by any authorities in the courts of this state or of the United States.

It is true that Mr. Justice BLATCHFORD, in the United States Circuit Court, in the case of *Flagg*, held that these October agreements were valid, upon the authority of *Hoyt v. Thompson* (19 N. Y. 207), and *McCullough v. Moss* (5 Denio 566); and that the General Term of this Department sustained the same in the case of *Content* (26 Hun 82), upon the ground that the October agreements were nothing more than a compromise and adjustment of claims which the Metropolitan and New York companies held against the Manhattan, and that the boards of directors having charge of the management of the affairs of a corporation, can always exercise this power of adjustment in the administration of the affairs of their corporation. The weight to be given to the decision by Mr. Justice BLATCHFORD has been much shaken by opinions given in our own Courts; and the ground upon which the decision of the *Content* case was based does not seem to be relied upon by the counsel for the defendants in the case at bar, although the case is presented as an authority in their favor. *If the October agreements are to be held to be simply as*

*a compromise and adjustment of an existing claim, then I am clearly of the opinion that the board of directors of the Metropolitan Company, without the assent of its stockholders, had the power to make them, within the principal involved in the case of Hoyt v. Thompson (19 N. Y. 207). But, in my opinion, these agreements are not susceptible of any such limitation. They are rather new agreements radically modifying and changing previous agreements, which for the purposes of the discussion in the present view, it must be conceded the directors of the Metropolitan Company had no power to make without the consent of the shareholders, and as to all the terms and provisions of which such shareholders had been consulted, and to which they had given their assent. It appears to necessarily follow that, if the directors have no power to lease without the assent of the shareholders, such shareholders might determine the terms and conditions of the lease to be given. If their consent is necessary, it must be because they are to be consulted as to the advisability and desirability of leasing their property, and that question depends almost always upon the terms and conditions of the lease proposed. Therefore, how can they intelligently act unless they know what is to be done? They might give their assent to a lease upon certain terms, and refuse it upon other conditions. The stockholders could, if they choose, give a power to lease to their directors, leaving the latter to determine the terms and conditions; but that was not done in respect to the agreements and leases of May 20th, 1879. The stockholders approved of these instruments after they were executed and after they had been read and considered. They consented to lease upon those terms and no other, and to say, that if the board of directors had no original power to lease they could, whenever they thought the exigency or the situation required, radically change and alter the terms and conditions of a lease granted by authority of shareholders, would be to deprive the shareholders of intelligent action.*

*If these agreements had merely been a settlement of existing claims due, or about speedily to become due, they might be considered as mere compromise agreements, but when they change in many substantial particulars the leases of May 20th, 1879, and that, too, for a period of over nine hundred years, I cannot see how they can be called mere compromise agreements.*

\* \* \* \* \*

There is no question, but that admitting that a board of directors alone have no power to lease the property of their corporation, if such lease is executed by the directors without the assent of the stockholders, such stockholders may accept the lease or repudiate it; and that if they allow the parties to the lease to go on under the lease without any action being taken in respect thereto, within a reasonable time, they will be held to have acquiesced in the lease and ratified it. Therefore, conceding that the corporation has the power to lease, when the action is taken and the stockholders have acquiesced, no third party can raise the objection that the stockholders have not formally assented.

\* \* \* \* \*

This brings me to the consideration of the remaining question:

*Were the agreements voidable at the option of the Metropolitan company, because three of its directors were also directors of the Manhattan company; or because Metropolitan directors held also stock in the Manhattan company?*

In considering this question, it must be conceded at the outset that the interests of the Manhattan company were directly antagonistic to those of the Metropolitan company.

In the negotiations which resulted in the October agreements, it was for the interest of the Manhattan company to get as large a reduction of rental as possible; and it was the interest of the Metropolitan company to secure as advantageous terms as the Manhattan company could comply with, and a similar interest pertained to the New York company; but it was to

the interest of neither to secure such terms as would bring about again the disasters under which the whole elevated system was then suffering.

Three propositions are urged in answer to the claim of the plaintiff, that the conflicting interests rendered the October agreements voidable. The first is, that although conflicting interests may disqualify an agent, strictly so called, from acting, that this rule does not apply to trading corporations, so many of whom have common directors. Secondly, if such conflicting interest induces any incapacity, it is not fatal to the agreement, if such agreement can be proven just and fair; and thirdly, that if any of the directors were disqualified because of an adverse interest, enough voted for the adoption of the agreement who were not disqualified, to have carried the measure, even if all the disqualified directors had voted no.

It will not be denied, I imagine, that as between natural persons, where an agent or trustee has a personal interest opposed to that of the principal, or where a man acts as agent of both parties to the contract, although he may have no personal interest on either side, the principal or *cestui que trust* may avoid the contract at will, even if there be no actual fraud or damage.

\* \* \* \* \*

It was intimated, that although this rule was so stringent as to purchases and sales, yet that it was not applied with the same rigor to other contracts. I have failed to find any foundation for this distinction either upon principle or authority. *It may be true that most of the adjudicated cases have arisen in reference to purchases and sales, but no distinction has been made by any court between contracts of this nature and any others, which were tainted with the same infirmity. There is no reason for any such limitation, and I do not find that it has ever been attempted to be enforced.*

\* \* \* \* \*

Reference is further made to the language used in *Angell & Ames on Corporations* §233, which is as follows :

“ By the common law, and by the Civil Code, too, as a corporation aggregate may contract with persons who

are not members, so it may contract with persons who are members of it; and the contract is not on this account invalid; a member of a corporation contracting with it being regarded, as to that contract, a stranger. Hence, a vote of the corporation affecting a contract between it and a member cannot bind the member without his assent to it. And though the member of the corporation be also one of the trustees of the corporation, it would seem that this would not incapacitate him from contracting with it; but he may recover against the corporation for his services rendered under a contract with the other trustees, in a case where there is no evidence of such gross partiality in the contract as amounts to fraud. And where the members of three distinct corporations were the same, yet, in *The Proprietors of the Canal Bridge v. Gordon* (1 Pick. 297), it was held by the Supreme Court of Massachusetts, that contracts between the several corporations were valid, *and might even be implied from corporate acts.*

\* \* \* \* \*

The language used by the court in its own opinion in *Twin Lick Oil Co. v. Marbury* (91 U. S. 587) seems, <sup>Twin Lick Oil Co. v. Marbury.</sup> certainly, to sustain the views of the learned counsel for the defendants upon this point. The court says :

“ That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts \* \* \* is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others (*Koehler v. Black River Falls Iron Co.*, 2 Black. 715; *Drury v. Cross*, 7 Wall. 299; *Luxemburg R. R. Co. v. Maquay*, 25 Beav. 586; *The Cumberland Coal &c. v. Sherman*, 30 Barb. 553; 16 Md. 456). The general doctrine, however, in regard to contracts of this class is, not that they are absolutely void, but that they are voidable at the election of the party whose interest has been so represented by the party claiming under it. We say, this is the general rule; for there may be cases where such contracts would be void *ab initio*; as when an agent to sell buys of himself, and by his power of attorney conveys to himself that which he was authorized to sell. *But, even here, acts which amount to a ratification by the principal may validate the sale.*

"The present case is not one of that class. While it is true that the defendant, as a director of the corporation, was bound by all those rules of conscientious fairness which courts of equity have imposed as the guides for dealing in such cases, it cannot be maintained that any rule forbids one director among several from loaning money to the corporation when the money is needed, and the transaction is open and otherwise free from blame. No adjudged case has gone so far as this. Such a doctrine, while it would afford little protection to the corporation against actual fraud or oppression, would deprive it of the aid of those most interested in giving aid judiciously, and best qualified to judge of the necessity of that aid, and of the extent to which it may safely be given.

"There are in such a transaction three distinct parties whose interest is affected by it; namely, the lender, the corporation, and the stockholders of the corporation.

"The directors are the officers or agents of the corporation, and represent the interests of that abstract legal entity, and of those who own the shares of its stock. One of the objects of creating a corporation by law, is to enable it to make contracts; and these contracts may be made with its stockholders as well as with others. In some classes of corporations, as in mutual insurance companies, the main object of the act of incorporation is to enable the company to make contracts with its stockholders, or with persons who become stockholders by the very act of making the contract of insurance. It is very true, that as a stockholder, in making a contract of any kind with the corporation of which he is a member, is in some sense dealing with a creature of which he is a part, and holds a common interest with the other stockholders, who, with him, constitute the whole of that artificial entity, he is properly held to a larger measure of candor and good faith than if he were not a stockholder. So, when the lender is a director, charged, with others, with the control and management of the affairs of the corporation, representing in this regard the aggregated interest of all the stockholders, his obligation if he becomes a party to a contract with the company, to candor and fair dealing, is increased in the precise degree that his representative character has given him power and control derived from the confidence reposed in him by the stockholders who appointed him their agent. If he should be a sole director, or one of a smaller number vested with certain powers, this obli-

gation would be still stronger, and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality and freedom from motives of selfishness. All this falls far short, however, of holding that no such contract can be made which will be valid ; and we entertain no doubt that the defendant in this case could make a loan of money to the company ; and, as we have already said that the evidence shows it to have been an honest transaction, for the benefit of the corporation and its shareholders, both in the rate of interest and in the security taken, we think it was valid originally, whether liable to be avoided afterwards by the company or not."

But I think that a careful examination of this case will show that the learned court's language was intended to show that such a contract was not absolutely void, so as not under any circumstances to afford the basis for future action or subsequent rights. The last clause of the language above quoted seems clearly to indicate this, which is : " We think it was valid originally, whether liable to be avoided afterwards by the company or not." In other words, it was valid at law, but subject to avoidance in equity by the company, if such right was exercised within a reasonable time ; and the sale in that case was upheld expressly upon the ground of laches. One of the grounds upon which it was sought to set aside the sale was because of certain declarations made by the defendant that he only designed to purchase the property for the benefit of all or a part of the shareholders ; and the court says :

" But we need not decide whether any of these declarations raised a legal obligation to do so or not, nor whether, without such declarations, the sale and deed were *voidable* at the election of the complainant—a proposition which is entitled to more consideration, resting solely on the fiduciary relations of the defendant to the plaintiff, than on the evidence in this case of the declarations alluded to. We need not decide either of these propositions, because plaintiff comes too late with the offer to avoid the sale."

This language is entirely consistent with the view that the court did consider such contracts, although

valid at law, voidable in equity *at the option of the corporation*, and the decision, as above stated, is put distinctly upon the ground of laches. This case, therefore, decides nothing whatever which is in any respect in hostility to the rule as laid down by the decisions in the courts of our own state. The learned court, in its language referring to the fact that a contract to repay money loaned made by a corporation with one of its directors, has been held to be valid, seems to have overlooked the fact, that in any event such a contract could not be repudiated by the corporation without the return of the money received by it, and, therefore, the result would be precisely the same if the transaction was open and free from blame, whether the contract was held to be voidable or binding, as the corporation could not disaffirm without returning the money loaned to it, and this seems to be the foundation of those cases holding such contracts valid.

*I think, therefore, that the undoubted rule of law in this State is, that every contract entered into by a director with his corporation may be avoided BY THE CORPORATION within a reasonable time, irrespective of the merits of the contract itself.*

*But we are asked, does this disability extend to the case of a contract between two corporations, some of whose directors hold that office in each corporation?*

*I can see no difference in principle between the case of a director contracting with his corporation and that of directors of one corporation contracting with themselves as directors of another corporation. The evils to be avoided are the same; the temptations to a breach of trust are the same; the want of independent action exists, and the divided allegiance is just as apparent. The fact that there is no such distinction is expressly stated in the case of *Wallace v. Long Island R. R. Co.* (12 Hun 460, 464). The court says:*

“The rule that persons acting in a fiduciary capacity shall not, directly or indirectly, make any profit by means of such acts, or be interested in contracts made by their principals, undoubtedly applies to directors of

corporations. It is a valuable principle, and ought not to be impaired by any subtle or refined distinctions. Still, the mere fact that the same persons were directors of the corporation which made the lease, and of that which took it, is not of itself sufficient to avoid the contract at the instance of one or more *stockholders*, against the will of the corporation. *That fact alone might entitle either corporation to avoid the lease, but I apprehend it does not give that right to a stockholder."*

The principle is here recognized that the majority of the shareholders may ratify a lease made by the directors, and that a minority cannot disaffirm. That, therefore, it must be the majority of the shareholders acting through the corporation who repudiate, and no shareholder has the power to exercise that right against the will of the majority.

\* \* \* \* \*

The case of *Booth v. Robinson* (55 Md. 419), it is claimed also decides that a contract is not voidable between corporations because of common directors. That case was an action brought by the stockholders of a corporation against some of its directors who were common directors in another corporation, upon an allegation that they, with an intent to cripple the corporation in which the plaintiffs were stockholders, made certain arrangements with another corporation in which they were directors, and in which the plaintiffs were not stockholders. The corporations were made parties defendant upon an allegation that these directors had control of the corporations, and by means of that control they could frustrate and defeat any attempt to induce the corporation to take action for the redress of the wrongs alleged. The court in that case says :

*Booth v.  
Robinson.*

"In these cases the proper and primary party to complain and call the directors to an account in a court of equity for fraud or breaches of trust in the management of the affairs of the corporation, is the corporation itself, because the duty is owing and the wrong is done directly to the corporation and only indirectly to the shareholders ; and, therefore, to ena-

ble a shareholder, either for himself alone, or for himself and others, to maintain a bill against directors for such fraud or breaches of trust, he must allege and show not only the violations of duty or breaches of trust on the part of the directors, but that he as a stockholder had been damnified thereby, and that the corporation has failed or refused to take the proper legal steps for the redress of the wrong."

The nature of the action, it will thus be seen was entirely different from that which is now before the court. It was an attempt upon the part of stockholders to assert their individual rights independent of the corporation, upon the ground of absolute fraud and mismanagement of the affairs of the corporation by certain of its directors. The fact that these directors held also the same offices in the other company, had nothing whatever to do with the cause of action involved, because independent of that fact a cause of action existed, if such fraud and gross mismanagement were shown. It is clearly stated in that case that the fraud must be proven, and that mere indiscretion, want of skill or deceit or mistake of judgment in the conduct of the affairs of the corporation affords no ground of personal liability on the part of directors. The court, therefore, says that two directors representing both corporations, this fact alone, while it should subject their conduct to rigid scrutiny by the court, does not afford ground of presumption against the legality and fairness of the dealings and transactions between the two companies. In other words, that upon the issue of fraud—actual fraud and gross mismanagement, the fact that these two directors had conflicting interests would be considered in determining that issue, and nothing else was meant by the court in the use of this language. The court then goes on and says :

"The two companies were certainly competent to contract the one with the other, and the two directors whose conduct is in question were interested in both companies, and by their relation to and official position in them, they owed duties and were bound to be faithful alike to both ; therefore, while acting within the scope of the affairs delegated to them by the stock-

holders of the corporation, there is no presumption of illegality or unfairness in their dealings and transactions as between the two companies. They were the chosen agents of both, and to be successful in any attempt to impeach the validity of their acts, with a view of making them personally responsible either to the corporation or to the stockholders, there must be distinct charges of misconduct fully supported by proof " (*Adams Mining Co. v. Senter*, 26 Mich. 73; *United States Rolling Stock Co. v. Atlantic and Great Western R. Co.* 34 Ohio St., 450).

Thus it will be seen that the court, in the use of this language, had in mind only the fact, that in order to make trustees personally responsible, it was necessary to prove actual misconduct, and that the mere fact that some of the directors of the two contracting corporations were common directors, did not necessarily establish that proposition. It must be fully supported by proof. And in support of this proposition, are cited the cases to which reference has previously been had—the one of which referred to the fact that an agent might act for both parties where his agency was known and his action approved, and the other that the *mere fact that two contracting corporations had common directors did not make their contract void in law but simply voidable in equity, which right might be lost by lapse of time.*

Therefore, all that seems to be established by the case above cited is that in order to hold directors personally responsible, affirmative proof of fraud, absolute fraud, is requisite. The power of corporations having common directors to loan and borrow money one from the other, and to give and to receive security therefor, is recognized and upheld, the court, however, not referring to the fact that such contracts, although voidable in equity, cannot be repudiated without the return of the money borrowed, and, therefore, the contract is allowed to stand, as there can be no object in entertaining an action for rescission, the borrower having a right upon tender of the money received to get its securities back without the intervention of a court

of equity, which is all the relief a court of equity can give.

These cases, therefore, cannot be held to overcome the adjudications of our own state, nor should they be held to have, in the slightest degree, shaken a principle so deeply imbedded in the rules governing the action of trustees with *cestuis que trust*. *In none of the cases has there been any attempt, as far as I have been able to discover, to distinguish between the disqualification of interest, as applicable to contracts between a director and his corporation, and such disqualification as applicable to contracts made between two corporations having common directors, they being treated as resting upon the same basis.* It seems to me that it has been conclusively shown by the authorities, both in England and this state, that any contract which may be entered into between a corporation with one of its directors *is voidable at the option of the corporation*, although it may be entirely valid at law.

\* \* \* \* \*

It is urged against this rule that if common directors are disqualified from acting, so are common shareholders incompetent to ratify agreements between their companies, and that the holder of one share of stock in each of the companies could prevent any action at a shareholders' meeting relating to the two companies, no matter how advantageous such action might seem to the holders of every other share of stock. I do not say that the disqualification extends to a shareholder. I can see no reason why it should. The disability rests entirely upon the fiduciary relationship. A shareholder is trustee for nobody; he has only his own interests to look after as such shareholder, closely connected as they undoubtedly are in practice with the interests of the other shareholders, but he holds no such fiduciary relation to the corporation as pertains to the office of director, and I think that it is carrying the rule to a much greater length than the reasons which have given it existence require, and in this respect the New Hampshire case of *Pearson v. Concord Railway*,

extends the disqualification too far and beyond all reason.

\* \* \* \* \*

I have, therefore, been led to the conclusion that the directors had no power to modify the leases of May 20th, 1879, in the manner that they did by the October agreements, without the assent of the stockholders ; and that even if they had such power, the presence of directors in the Metropolitan board, who were also directors of the Manhattan company at the time of the adoption of these October agreements, *gave either company the right, in equity, to repudiate those contracts within a reasonable time, although the contracts may have been perfectly valid at law.*

The Metropolitan company certainly did repudiate these agreements within a reasonable time, having commenced this action within one month after the shareholders of that company had an opportunity to elect a new board of electors, who could take action in the matter.

The plaintiff, therefore, is entitled to a judgment relieving all the parties in this action from the October agreements, upon making such restitution as is suggested in a former portion of this opinion.

*It has been said that this conclusion, if reached, would cause great confusion and conflict of interest among a vast number of railroads in this country, so many of whom have common directors and also traffic arrangements with each other. This evil is not so great by any means as has been depicted. Agreements of this character are not void, but simply voidable, and if the corporation wishes to avoid them, as has been shown, it must act within a reasonable time. If the shareholders are dissatisfied with the acts of their directors, they must repudiate them within a reasonable time, which in most cases would be held to mean at the next meeting for the election of directors, when they can elect a new board, who can take the necessary action to annul the voidable contract ; and it must, therefore, be the dissatisfaction of the majority of the shareholders, and not that of a minority, which can call the power into operation. If the shareholders*

*renew the terms of office of the directors who have made the voidable contract, or if they take no action showing plainly their dissent, the contract will become binding by acquiescence. As in most corporations boards of directors are elected by the shareholders annually, the right to annul can seldom exist for more than one year. Thus it will be seen that there can be but few cases in which the decision of these questions can affect past action, whatever influence it may have in shaping the proceedings of trading corporations hereafter.*

[112 N. Y. 1, 27.]

**Beveridge v. New York Elevated Railroad Company.**

GRAY, J. \* \* \*

The next step brings us, then, to the agreements of October, 1881, by which the leases were modified, in the principal feature of the reduction of the payments agreed to be made, from ten to six per cent. About this action of the directors little need be added, in view of the previous discussion of the extent of their powers. We hold that it was quite competent for them to make those agreements without any concurrent action or ratification by the stockholders. No fraud is found or proven against them in taking this action, and it seems not an unreasonable or an improper exercise of business discretion, in view of the embarrassments in which the insolvency of the Manhattan company had involved itself and its lessors. *To have, in good faith and with apparent reasons, agreed to reduce the amount of moneys payable under the lease by their company, was not an act in excess of the power of the directors, or one voidable at the instance of the stockholders. It was as much within their province and authority and as such, a part of the ordinary business of the corporation, as would be the reduction of the interest secured in a bond to the corporation, or the rent reserved in a lease of some building, or any other act lying in the exercise of business judgment.*

*The question of the exercise of such a power of management must be left to the honest and fair business discretion of the board of directors, and the only inquiry by the stockholders could be as to whether there was any fraud by which assets were wrongfully diverted. They must be presumed to act for the best interests of the corporation and to give to the management and disposition of its property their best judgment. But when, subsequently, the agreement of No-*

vember, 1881, for the merger or transfer of the capital stock of the lessor companies into that of the lessee was, as to the New York company, given practical effect, by the exchange of upwards of fifty-eight thousand shares out of a total of sixty-five thousand shares, that fact, under any aspect of the case, expressed the decided acquiescence of nearly nine-tenths of the corporators in what had been done. While the action of other shareholders may not, in the merging of their stock, affect any legal rights of the non-merging shareholders, it may not improperly be referred to in the endeavor to discover the sentiments of the general body of corporators as to corporate action taken by their directors. *The appeal to equity, when the acts complained of are within the powers of directors and apparently uninfluenced by corrupt motives or personal interests adverse to those of stockholders, ought, at least, to be justified by some showing that these acts were improper within the belief of a fair proportion of the body of stockholders.*

Coming then, to the condition of affairs, which followed upon the decision of Judge VAN BRUNT being known, we do not find in it any origin for this action by the plaintiff. In May, 1884, the stockholders of the New York and Manhattan companies approved agreements for the surrender to the New York company by the Manhattan company of the leased property and for the retransfer of the stock, exchanged for the stock of the New York company.

Although Judge VAN BRUNT's decision was rendered upon the complaint of the Metropolitan company, and avoided the October agreements as to that company, it so affected the contractual relations of all of the companies as to seem to make some action necessary. It had no such effect upon the New York company's stockholders as to avoid those agreements; and no action had been, nor, in our opinion, could have been taken by the company, or its stockholders, to annul the October agreements. The stockholders could not be heard to say that they acquired any rights under that judgment with respect to the past. It is sufficient

that such action was deemed necessary, as was had in May 1884, for the severance of the contractual relations established by the lease, and it was a matter, we think, which was also within the exercise of an honest discretion by the directors. Although not legally requisite, their action was approved by the great majority of the votes cast on May 6, 1884, by the holders of the New York company's stock.

[12 Hun, 460.]

**Wallace v. Long Island Railroad Co.**  
**(1877, Second Department.)**

[DYKMAN, J., with BARNARD, P. J., concurring upon the opinion of GILBERT, J.]

Appeal from an order dissolving a preliminary injunction granted to the plaintiffs herein and denying their motion to continue the same.

The plaintiffs individually and on behalf of themselves, and of such other stockholders and bondholders of the Long Island Railroad Company, as might elect to come in and contribute to the expenses of this action, showed among other things, that the plaintiffs were interested as stock or bondholders, or both, in the Long Island Railroad Company; also, in the New York and Rockaway Railroad Company, which had been leased and its bond guaranteed by the Long Island Railroad Company; also, in the Smithtown and Port Jefferson Railroad Company, which had been leased and its bonds guaranteed by the Long Island Railroad Company, or in one or more of the aforesaid companies.

That on May 3, 1876, the Long Island Railroad Company made an agreement for the lease of the Flushing, North Shore and Central Railroad Company, and about the same time a similar contract, for the leasing of the Southern Railroad Company of Long Island, the Long Island Railroad Company paying each of the two last named companies an annual rent greatly exceeding the net earnings of said roads respectively.

It was further claimed that the Flushing, North Shore and Central Railroad Companies and the Southern Railroad Company of Long Island were not connecting roads with the Long Island railroad.

That several of the parties defendant in this action, who are directors of the Long Island Railroad Com-

pany, are also directors and officers in both the Southern Railroad Company of Long Island and the Flushing, North Shore and Central Railroad Company.

That the defendant, Conrad Poppenhusen, and others, acting in concert with him, have caused a meeting of the stockholders of the Long Island Railroad Company to be called, and he, together with other stockholders of said company, holding sufficient stock, so to do, proposed and threatened that they would at such meeting take such action as would result in the said Long Island Railroad Company guaranteeing the payment of the principal or interest, or both, of the said bonds of the Flushing, North Shore and Central Railroad Company, and also of the Southern Railroad Company of Long Island, as it was provided in the aforesaid agreements of lease might be done.

That such guarantee would result in greatly depreciating the stock and bonds belonging to the plaintiffs and others.

The complaint asked that the Long Island Railroad Company, its agents and the other defendants in this action be enjoined from carrying out the agreements above referred to.

A temporary injunction, with an order to show cause why the defendants should not be further restrained during the pendency of the action was granted; and on the return day thereof, the injunction was vacated, Judge GILBERT writing the following opinion:

GILBERT, J. :

\* \* \* \* \*

[The opinion begins by discussing the legal power of the Long Island Railroad Company to make the lease in question.]

I cannot say that the directors of the Long Island Railroad Company have abused the power mentioned, or that they fraudulently entered into the leases in question. They may have erred in judgment, but the

Court has no power to control the lawful exercise of the discretion vested in them as officers of the corporation. *I see no reason for imputing to them bad faith or fraud.* That being so, I am of opinion that a stockholder in that company is not entitled to have the leases avoided in opposition to the wishes of the parties to them. The directors are, no doubt, in one sense, trustees of the stockholders, but, primarily, they are trustees of the corporation. *If the corporation, acting with the approval of the holders of the major part of the stock thereof, prefer to abide by the leases, they cannot be avoided on the complaint of a minority of the stockholders against the will of the corporate body so manifested, and in absence of evidence that the holders of the major part of the stock disapprove the acts of the directors, their approval thereof must be presumed.* In other words, the leases in question, although *infra vires*, may be voidable at the election of the corporation. But the plaintiffs are not entitled to make such election in behalf of the corporation. Nor can the Court compel the corporation to make the election against the will of the holders of a major part of the stock thereof. The management of the concerns of the corporations has, by the charters, been committed to the directors thereof respectively, and their acts within the corporate powers done in good faith, are valid and binding, not only on the corporation, but on each stockholder thereof. The rule that persons acting in a fiduciary capacity shall not directly or indirectly make any profit by means of such acts, or be interested in contracts made by their principals, undoubtedly applies to directors of corporations. It is a valuable principle, and ought not to be impaired by any subtle or refined distinctions. Still the mere fact that the same persons were directors of the corporation which made the lease, and of that which took it, is not of itself sufficient to avoid the contract at the instance of one or more stockholders against the will of the corporation. That fact alone might entitle either corporation to avoid the lease, but

I apprehend it does not give that right to a stockholder. In the cases cited on behalf of the plaintiffs, and in all the cases I have met with, where contracts have been avoided on that ground, the relief was sought or assented to by the corporation. Here all the corporations whose acts are assailed insist that they are valid and *mutually beneficial*, and that they be upheld. It seems to me, that to grant the injunction asked for *would be to annul the acts of the trustees* against the wish of their *cestuis que trust*, or the acts of agents which have been ratified by their principals, and which the latter now, through their counsel, before the court, insist shall be carried into effect. I know of no principle which would warrant such a proceeding.

That motion to continue the injunction must be denied, and the injunction must be dissolved with ten dollars costs.

[41 Hun, 109.]

**MacNaughton v. Osgood, (1886, Third Department)**

[Reversed in 114 N. Y. 574, upon purely technical grounds not affecting the points decided below.]

The action was brought to restrain the officers of a corporation from paying to themselves salaries fixed by them in their own favor, and to compel them to refund the amount already received.

LANDON, J. :

We assume that the directors of a corporation are trustees ; that the corporation is their *cestui que trust*; that for any violation of their duty to the corporation, *whereby it is injured in its estate*, the directors are personally liable to it ; that a stockholder may, in case the corporation refuses to enforce its remedy, or is prevented from doing so by the control of the directors who have done the wrong, bring it and the wrongdoing directors into court and thus have the remedy enforced.

The statute (Code Civ. Proc. sec. 1781, subs. 1, 2) sanctions such an action, and a previous demand of the corporation to bring the action is unnecessary when it is wholly under the control of the directors whose wrong is complained of. (*Brinkerhoff v. Bostwick*, 88 N. Y. 52-59.) The directors cannot lawfully so control the corporation so as to make it a party to a contract with themselves, wherein their personal interests are involved upon one side and the interests of the corporation on the other. (*Hoyle v. Plattsburgh and Montreal R. R. Co.*, 54 N. Y. 314 ; *Blake v. Buffalo Creek R. R. Co.*, 56 N. Y. 486.) Since the corporation is unable to negotiate, decide, act or think except through its officers and agents, such officers and agents are bound to negotiate, decide, act and think for it with entire fidelity to its best interests. Such fidel-

ity is not presumed when the private interest of the officer or agent is in conflict with the interest of the corporation. The authorities in support of this proposition, and most of those above set forth, are collected and discussed in the able opinion of Judge VAN BRUNT, in *Metropolitan Elevated Railway Company v. Manhattan Railway Company* (14 Abb. N. C., 103). If, however, such a contract should be made between the directors and the corporation, the contract is not absolutely void, but it is void or valid as the corporation, when freed from the control of its interested directors, may elect. (*Barnes v. Brown*, 80 N. Y., 527.) It is possible that a contract so made may be in the highest degree beneficial to the corporation, and the law does not disable it from adopting its benefits.

It follows that the resolutions adopted by these three directors, fixing the salary of one of them as president, and of the other as secretary and treasurer, and providing somewhat indefinitely for the compensation of the third as vice-president, are not binding upon the corporation. The corporation is under the control of these three directors, and has thus presumably been disabled from exercising its right to exercise its election to adopt or avoid these resolutions.

The plaintiff, by this action, brought the corporation and its three directors into court, and asks, upon substantially an undisputed state of facts, that the resolutions be avoided and the salaries paid under them be restored to its treasury. Under the circumstances, the corporation should be adjudged to do and receive what the evidence shows it is just that it should do and receive. The plaintiff, by bringing the action, undertakes to make out a case. He contends, however, that having shown the fiduciary relation of the directors, and that they adopted these resolutions to their own advantage, and have received their pay in pursuance of them, that the presumption is that they acted dishonestly, and that the burden rests upon them to overcome, by affirmative evidence, this presumption.

Now, if the corporation had elected to rescind these resolutions and had brought its action to recover the salaries paid under them, doubtless the burden would have rested upon the directors to overthrow the presumption, if, in any aspect of the case, it would be material to do so. But the plaintiff is a volunteer champion of the cause of the corporation. The court does not interfere in the management of a corporation, except in a clear case demanding such interference. (*Barnes vs. Brown, supra* ; *Chataqua Co. Bank vs. Risley*, 19 N. Y., 381 ; *Hawes vs. Oakland*, 104 U. S., 460.)

It is not clear from the simple fact that the directors voted themselves salaries and received them, that *the corporation has been injured*. It is conceivable that this action was beneficial to the corporation. The corporation has received, in consideration, the valuable services of these officers. If these officers had not rendered these services others would need to have been employed, and from the nature of the services, especially those of Mr. Osgood, the inventor of the machines which constitute the principal value of the enterprise and business, it might not have been able to employ any one who could so efficiently perform them ; besides, there is a manifest propriety in a corporation employing those who are most interested in its success, and are also best able to promote it, and hence follows the duty to render them reasonable compensation. (*Jackson vs. N. Y. C. R. R. Co.*, 2 Sup. Ct. (T. & C.) ; *Talcott v. Olcott Mfg. Co.*, 11 W. Dig., 141.) The corporation may avoid such a contract with its trustee, but cannot do so except upon equitable terms, and must restore to him what it received from him. (*Duncomb v. N. Y. H. & N. R. R. Co.*, 84 N. Y., 190.) Hence the corporation, upon rescinding, ought to pay the reasonable value of the services of these officers, rendered in a department of labor beneficial to it, and outside of the duty of direction which the office of director implies. See *Metropolitan Elevated Railway Company v. Manhattan Railway Company* (14 Abb. N. C., at pages 258, 259), where the case

of *Jackson v. New York Central Railroad Company* (2 Sup. Ct., [T. & C.] 653; affirmed 58 N. Y., 623) is commented upon, and the cases are cited in which the right of a director to recover for such services is shown to rest solely upon a *quantum meruit*, and such we have no doubt is the law.

The plaintiff is not the corporation, his right to champion its interests must rest upon his showing affirmatively that it needs him somewhat in the character of its guardian *ad litem* to bring it into court *for its proper protection*, and hence the burden rests upon him to make such a case as will show that the corporation *ought* to exercise its right to avoid the resolution or contract made by its directors, in which they were personally interested.

There is a plain distinction between a case in which the corporation may, at its own option, avoid such a contract, and a case in which the corporation, from the fact that it is despoiled and in the hands of its spoilers, *ought to be adjudged* to avoid it. The plaintiff made the former case, but not the latter, and hence the judgment should be affirmed."

[89 Hun, 316.]

**Hart vs. Ogdensburg & L. C. R. R. Co.,  
Third Department, 1895,**

[PUTNAM, P. J., HERRICK and FURSMAN, JJ., concurring.]

[The report deals with two actions, the first an action by stockholders and the second an action by bondholders. The action of the bondholders is deemed immaterial to the present purpose and such portions of the report as deal with it are omitted. The opinion with such omissions and certain other omissions indicated, is as follows]:

“ PUTNAM, P. J. :

The objection is also made to the lease that when executed the Central Vermont Railroad Company, through its agents, controlled the Ogdensburg and Lake Champlain Railroad Company and that directors, officers and agents of the former were directors of the latter.

It is held that a contract made by a director of a corporation with it is voidable by the corporation, and it has also been decided that the same rule applies to a contract by the directors of a corporation with another corporation of which they are also directors. This principle is considered in the very able and exhaustive opinion of VAN BRUNT, J., in *Metropolitan El. R. R. Co. v. Manhattan El. R. R. Co.* (11 Daly, 373, 502, 503). The case cited, however, recognized the doctrine laid down in *Wallace v. Long Island R. R. Co.* (12 Hun, 460), that a contract entered into between two corporations, voidable because of their having common directors, could not be disaffirmed by a minority of the stockholders; that “the rule that persons acting in a fiduciary capacity shall not, directly or indirectly, make any profit by means of such acts, or be interested in contracts made by their principals, undoubtedly applies to directors of corporations. It is a valuable principle and ought not to be impaired by any subtle or refined distinctions. Still, the mere fact that the same persons

were directors of the corporation which made the lease, and that which took it, is not of itself sufficient to avoid the contract at the instance of one or more stockholders against the will of the corporation. That fact alone might entitle either corporation to avoid the lease, but I apprehend it does not give that right to a stockholder." And VAN BRUNT, J., remarks in *Metropolitan El. R. R. Co. v. Manhattan El. R. R. Co.* (*supra*), referring to the doctrine laid down in *Wallace v. Long Island R. R. Co.* : 'The principle is here re-recognized that the majority of the stockholders may ratify a lease made by the directors, and that a minority cannot disaffirm. That, therefore, it must be the majority of the shareholders acting through the corporation who repudiate, and no shareholder has the power to exercise that right against the will of the majority.'

I concur in the views thus stated. (See, also, *Gamble v. Q. C. W. Co.*, 123 N. Y. 92-98.)

I, therefore, conclude that the objection alleged in the complaints to the lease on the ground that some of the directors of the Ogdensburg and Lake Champlain Railroad Company were also directors, agents, officers or attorneys of the Central Vermont Railroad Company was properly overruled by the court below.

\* \* \* \* \*

(The opinion then discusses a question of laches).

I concur in the views of the court below that the allegations in regard to the alleged improper division of the earnings of the two corporations by the Central Vermont Railroad Company contain no cause of action. Sufficient facts are not stated to justify interference by a court of equity in the affairs of the two corporations. It does not appear to what extent the Central Vermont Railroad Company has taken earnings that should have gone to the other defendant. It is well settled that ordinarily the court will not interfere with the control of a corporation by its directors and a majority of its stockholders. It will not interfere although the directors may have acted unwisely and not for the best interests of the corporation they represent. To justify

the interference of the court with the management of a corporation on the application of a minority of the stockholders it must be shown that the action of the governing body complained of has been so clearly *against the interests* of the minority of the stockholders as to amount to a wanton and fraudulent *destruction of the rights of such minority*. It must appear that the action of the majority of the stockholders and directors is a *clear, substantial and flagrant violation of the rights of the minority*. (*Gamble v. Q. C. W. Co., supra.*)

The complaints do not allege such a state of facts as shows a fraud on the minority, and is not sufficient under the doctrine laid down in *Gamble v. Q. C. W. Co. (supra)* and kindred cases.

\* \* \* \* \*

(The opinion then discusses an allegation of the complaint which was contended to be an allegation of waste and finds that the complaint did not so state it).

The second and subsequent causes of action in the complaints to which the demurrers were interposed, relate to the proposed consolidation of the two defendants. The agreement for such consolidation between the directors of said corporations was made about six years after the execution of the lease.

The position taken by plaintiffs, that the agreement for consolidation made by the directors of the two corporations when the actions were commenced is of no force, because the Central Vermont Railroad Company had elected as directors of the Ogdensburg and Lake Champlain Railroad Company some of its own directors, officers and agents, and because said corporations, with common directors, could not lawfully contract with each other, has already been considered. The contract was voidable but not void; it could be ratified by a majority of the stockholders. If it was so ratified and otherwise valid and legal, it could not be set aside at the suit of the minority stockholders.

\* \* \* \* \*

(The opinion then discusses certain contentions of bondholders)

The plaintiffs allege that the proposed agreement is in every way disadvantageous to and opposed to the interests of the Ogdensburg and Lake Champlain Railroad Company. That the earnings of said road had greatly increased during the six years of the existence of said lease. That it is a connecting link between the States of New England and the west, and is of great value by reason thereof. That the Central Vermont Railroad Company has never paid a dividend and its stock has never been dealt with in the market and has no market value, yet the agreement of consolidation proposes that one share of stock of the new company to be formed shall be given in return for ten shares of the capital stock of the Ogdensburg and Lake Champlain Railroad Company, while one share of said new stock shall be exchanged for one share of the stock of the Central Vermont Railroad Company.

The cases in which an action by a minority of the stockholders of a corporation to restrain the proposed action of its directors and a majority of the stockholders can be maintained are considered in the opinion of PECKHAM, J., in *Gamble v. Q. C. W. Co.* <sup>Gamble v. Q. C. W. Co.</sup> (*supra*). The learned judge remarks:

‘I think that where the action of the majority is plainly a fraud upon, or, in other words, is really oppressive to the minority shareholders, and the directors or trustees have acted with and formed part of the majority, an action may be sustained by one of the minority shareholders suing in his own behalf and in that of all others coming in, etc., to enjoin the action contemplated, and in which action the corporation should be made a party defendant. It is not, however, every question of mere administration or of policy in which there is a difference of opinion among the shareholders that enables the minority to claim that the action of the majority is oppressive, and which justifies the minority in coming to a court of equity to obtain relief. Generally, the rule must be that in such cases the will of the majority shall govern. The court would not be justified in interfering even in doubtful cases, where the action of the majority might be susceptible of different constructions. To warrant the interposition of the court in favor of the minority shareholders in a corporation or joint-stock associa-

tion, as against the contemplated action of the majority, where such action is within the corporate powers, a case must be made out which plainly shows that such action is so far opposed to the true interests of the corporation itself as to lead to the clear inference that no one thus acting could have been influenced by any honest desire to secure such interests, but that he must have acted with an intent to subserve some outside purpose, regardless of the consequences to the company and in a manner inconsistent with its interests. Otherwise the court might be called upon to balance probabilities of profitable results to arise from the carrying out of the one or the other of different plans proposed by or on behalf of different shareholders in a corporation, and to decree the adoption of that line of policy which seemed to it to promise the best results, or at least to enjoin the carrying out of the opposite policy.'

Under the doctrine thus laid down sufficient facts are not stated in the complaints to show that the proposed agreement is so much opposed to the interests of the Ogdensburg and Lake Champlain Railroad Company as to sustain an action. The allegation that the agreement is in every way disadvantageous to the last-named corporation and advantageous to the Central Vermont Railroad Company is merely a statement of a conclusion." \* \* \* (The opinion then discusses certain particular allegations).

I think, therefore, that the plaintiffs, so far as they have attempted to show that the proposed agreement of consolidation is *disadvantageous to the interests of the stockholders* and bondholders of the Ogdensburg and Lake Champlain Railroad Company, fail to set forth such a state of facts as authorizes the maintenance of these actions within the doctrine laid down in *Gamble v. Q. C. W. Co. (supra)*.

\* \* \* \* \*

(The opinion concludes with discussion of an order allowing an extra allowance).

The judgments and order should be affirmed, with costs.

[125 N. Y. 263-279.]

**Barr v. New York, Lake Erie & Western  
Railroad Company.**

[In this case, the plaintiffs, as stockholders of the Suspension Bridge & Erie Junction Railroad Company, brought action against that Company and the New York, Lake Erie & Western R. R. Co. to compel payment of a certain rental according to the terms of a lease under which the last named Company was operating the railroad of the former Company. The sole defense was that the lease was made by interested and common directors, and was therefore void and unenforceable against the defendant corporation. This point is made perfectly clear by the two following extracts from the opinion of the Court, delivered by Judge GRAY.]

GRAY, J.— \* \* \* \* \*

The contention is, therefore, brought to this point : Did the Suspension Bridge Company have a cause of action against the present successor, in interest of its original lessee? All questions are eliminated from the controversy as to the liability of the New York, Lake Erie and Western Railroad Company to the Suspension Bridge Company, save the one of whether the taint of original fraud in the procurement of the lease operates to prevent the enforcement of the obligations of that instrument. That the contract of lease was voidable and quite indefensible, because of the immoral conduct of directors, who abused their trust in procuring its execution, I quite concede. The proofs could lead to no other finding than that the lease and the rental guarantees were the work of a combination, or syndicate, composed of members from the boards of directors of the two companies, who caused the same to be made by the Erie Company for purposes of their own individual gain and in fraud of that company's rights. The identity of certain of the directors of each company, when the lease was made ; the interest of four of these common directors in the

contract for the construction of the Suspension Bridge road and in the stock and bonds to be guaranteed, as a condition of the leasing of the road, stamped the whole transaction as a fraud upon the Erie Company and brought it under the condemnation of the rule, which forbids those who fill fiduciary positions from making use of them to benefit their personal interests. This rule is deservedly strict in its requirements and operation. It extends to all transactions where the individual's personal interest may be brought into conflict with his acts in a fiduciary capacity, and its works independently of the question of whether there was fraud, or whether there was a good intention. Where the possibility of such a conflict exists, there is the danger intended to be guarded against by the absoluteness of the rule. (*Davoue v. Fanning*, 2 Johns. Ch. 260; *Barnes v. Brown*, 80 N. Y. 527.) *But the rule does not operate to avoid ab initio all transactions of a trustee, where he is interested; but is generally limited in its operation to rendering them voidable, at the election of the party whose interests are concerned in the question of their affirmance or disaffirmance. If, therefore, nothing is done in avoidance, the transaction remains. If knowledge and opportunity concur, whereupon to move, delay, if unreasonable, or attended by retention and enjoyment of the results of the transaction, may be deemed equivalent to an adoption and ratification of that which before was the subject for action, in repudiation of any obligation. The rule is not designed to work injustice, but to protect those who repose confidence, voluntarily or perforce, in others holding towards them fiduciary positions and to whose care have been confided the management and custody of property and of interests. (Duncomb v. N. Y., etc., R. R. Co. 84 N. Y. 193, 199.)*

But that the plaintiffs were parties to a scheme for imposing a continuing obligation upon the Erie Company, and knew, or were chargeable with knowledge of the fraudulent devices to bring about that obligation, are not sufficient, at this day, as facts in defense of

this action. It is the respondent's own attitude and the conduct and acts of its predecessor in interest, which create the difficulty in defending against the demand of these plaintiffs.

*The vice in the original transaction, from the collusion between a combination of the common directors with others, does not necessarily so inhere in the agreements of the lease as to prevent ratification, or to survive acts amounting in effect to acquiescence and waiver on the part of the Erie Company and its successors in interest.*

\* \* \* \* \*

*I have said that this contract of lease was voidable and not void, and, therefore, could be and was, upon the showing of this record, validated by acquiescence and adoption. It was a good enough contract at law, but because of the immorality of directors, common to both contracting companies, combining to procure the execution of a contract in which they were personally interested, a court of equity could interfere and set it aside at the instance of the injured party. The right, however, to invoke the equitable interference of the courts depends upon the circumstances of the case, and aid will be denied where, in a case like the present one, the contract has been executed, unless the party claiming to be injured acts diligently, in asserting a right to rescind, and honestly, by yielding up what came to it and continues to be held and enjoyed under the contract.*

The cases are many in which has been discussed the equitable rule that such contracts are not absolutely void, but only voidable, and, notwithstanding the vice or immorality which tainted their origin, may be validated. The opinions in *Thomas v. Brownville, etc. R. R. Co.* (109 U. S. 522); *Twin Lick Oil Co. v. Marbury* (91 *id.* 587); *Duncomb v. N. Y., etc., R. R. Co.* (84 N. Y. 193); *Risley v. Indianapolis, etc. R. R. Co.* (62 *id.* 240), and *Barnes v. Brown* (80 *id.* 527), are sufficient to be referred to upon that subject, and further elaboration is quite unnecessary.

The authorities relied upon by the court below at General Term do not conflict with our views of this case. *Munson v. R. R. Co.* (103 N. Y. 58) was an action to compel the specific performance of an agreement affected by the vice that a director of the defendant corporation was a party to it *and participated in the action of the corporation in assuming the obligation.* The agreement, in substance, was for the sale of certain railroad property held by the plaintiffs, and its purchase by the defendant corporation. The court, it was there held, would not aid in the enforcement of this *executory* contract, for it was "repugnant to the great rule of law which invalidates all contracts made by a trustee or fiduciary, in which he is personally interested, at the election of the party he represents." *This is not the present case, where the contract was executed and its results retained and enjoyed long after the opportunity for repudiating it because of the facts underlying the transaction.*

\* \* \* \* \*

It is quite a misapprehension of the matter to treat the contract of lease as in itself illegal and, therefore, incapable of enforcement in the courts. The contract was not illegal in itself, but, on the contrary, was one the companies could enter into, through the action of their directors, with perfect propriety. What happened, as the result of the combination of persons and of directors common to each contracting company, was that that fact infected the agreement, and impaired its binding force as an obligation. It did not annul or destroy it, but subjected it to the condemnation of the law. A court of equity could give relief against it, but whether it would exert its power would necessarily depend upon the circumstances of the case, and the conduct of the parties. Delay and conduct inconsistent with a purpose to throw up the lease are sufficient reasons for holding the contract to have been validated and the objection to it waived.

[15 Misc. 187.]

**The Genesee Valley & Wyoming Railway  
Co. vs. Retsof Mining Co. (Supreme  
Court—Monroe Special Term, 1895).**

Motion by the plaintiff for an injunction to restrain any interference by the defendant with the plaintiff's railroad and property during the pendency of the action.

ADAMS, J. :

\* \* \* \* \*

[The opinion begins with a discussion of matters not material to the case at bar, and proceeds, at page 194] :

The objection that the directors of the defendant were also interested in the railroad company at the time this supplemental contract was entered into is not, *in the absence of fraud or bad faith*, I apprehend, entitled to much weight, and it is not intimated that either of the parties to the instrument was guilty of bad faith. On the contrary, it was executed because it was supposed it would prove beneficial to both. It was said in the case of *Wallace v. Long Island R. R. Co.*, (12 Hun, 460,) that the fact that the same persons were directors of the leasing and leased railroad might of itself entitle either corporation to avoid its contract, but that it was insufficient to avoid it at the instance of one or more stockholders. This, however, seems to be the mere expression of an opinion, and does not harmonize with the language which preceded it, wherein it is stated that all acts of the directors of a corporation, within their corporate powers, and 'done in good faith, are valid and binding not only upon the corporation, but upon each stockholder thereof.'

The rule contended for by the learned counsel for the defendant has been considerably relaxed of late

years. Indeed, it would be difficult to conduct the affairs of the multifarious corporations of the country, many of which, although apparently sustaining the relations of rivals in business, are, nevertheless, practically controlled by the same directors, if the element of good faith, instead of individual interests, were not established as the basis of intercorporate action. *Van Cott v. Van Brunt*, 82 N. Y. 535; *Gamble v. Queens Co. Water Co.*, 123 *id.* 91; *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587."

(The opinion concluded with a discussion of the remedy of injunction).

[8 App. Div. 160.]

**Burden v. Burden.**

[1896, Third Department.]

Appeal by the plaintiff, Isaiah Townsend Burden, from a judgment of the Supreme Court in favor of the defendants, entered in the office of the clerk of the county of Rensselaer on the 17th day of November, 1893, upon the decision of the court rendered after a trial at the Rensselaer Special Term. \* \* \*

Judgment affirmed with costs, *on opinion in the court below.*

All concurred.

[The following is the opinion of the court below :]

EDWARDS, J. :

\* \* \* \* \*

Another question in the case arises out of the purchase by the Burden Iron Company of the ore of the Hudson River Ore and Iron Company for use in the manufacture of pig iron. Of the one and a half million of dollars of stock of the last-named corporation, James owns about \$400,000, Arts \$22,000 and the plaintiff none.

James is also one of the directors. In April, 1883, the Burden Iron Company began to buy this ore to mix with other ores in the production of pig iron in its blast furnaces, and the proportion of such ore in the mixtures used has increased from five to fifty per cent. It is claimed by the plaintiff that the defendants Burden and Arts, for the purpose of furthering their interests as stockholders in the Hudson River Ore and Iron Company, have persisted, against the protests of the plaintiff, in buying the ore of that company to the detriment of the plaintiff and of the Burden Iron Company, and that the defendants should be permanently enjoined from the further purchase or use of such ore. A vast amount of testimony has been taken as to the relative value and productiveness of this ore in the

manufacture of pig iron, and as to the alleged wrongful purpose of Burden and Arts in its purchase ; and, after a careful examination, I have reached the conclusion that such ore was purchased and used in the exercise of their best judgment, without bad faith and without any pecuniary injury to the plaintiff as a stockholder in the Burden Iron Company. *But the plaintiff contends that irrespective of any actual fraud in the purchase he is entitled to the relief sought for the reason that James A. Burden is a director in both corporations, and that such purchases are, therefore, within the condemnation of the law.*

He invokes the settled rule of law which declares voidable all contracts made between two corporations having one or more common directors. It is familiar doctrine that a contract made by an agent or trustee is voidable, at the election of the principle or person represented, in all cases where the fiduciary has any personal interest in the contract. The law does not permit one to act in the dual character of principal and agent and when one assumes such a character it declares the transaction invalid, at the election of the person represented, without regard to the question whether it was fair or otherwise. This principle of agency applies not only to a contract between a director and the corporation which he represents, but also to contracts between two corporations having common directors, and this notwithstanding the fact that a majority of the directors of each corporation, exclusive of the common directors, voted for the contract. A trustee represents the corporation, and he cannot have two principals with conflicting interests. There can be no divided allegiance. (*Munson vs. S. G. & C. R. R. Co.*, 103 N. Y., 58 ; *Metropolitan El. Ry. Co. vs. Manhattan El. Ry. Co.*, 14 Abb. N. C., 251.) I think there can be no doubt that the law would set aside or refuse to enforce, *at the instance of either of these corporations*, an executory contract between them for the sale of ore, on the sole ground of the two corporations having a common director. But will the law, on that ground, interfere at the instance of a

stockholder? On principle, as well as authority, I think not. All the authorities hold that such a contract is *not void*, but is *voidable* only at the election of the principal. The director holds a fiduciary relation to the corporation, and with the corporation rests the election to disaffirm. If the right to disaffirm rests with a stockholder, then, however small his holdings may be, he can nullify the contract, *however beneficial* it may be to the corporation, and however subversive may be his conduct of the will and interests of a majority of the stockholders. Stockholders act through directors who represent the corporation. If the majority stockholders deem the contract unwise and desire to disaffirm, they may elect a Board of Trustees, who will execute their wishes; and, if they deem it otherwise, there is no reason why a single stockholder, or the minority stockholders, should be permitted to subvert their wishes.

In *Wallace v. Long Island Railroad Company* (12 Hun, 460) the plaintiffs, who were stockholders in the defendant corporation, which had taken a lease of two other roads, some of the directors of the defendant being also directors of the leased roads, sought to enjoin the carrying out of the lease.

\* \* \* \* \*

(The Court here quotes at length from the Wallace case.)

The rule that persons acting in a fiduciary capacity shall not, directly or indirectly, make any profit by means of such acts, or be interested in contracts made by their principals, undoubtedly applies to directors of corporations. It is a valuable principle and ought not to be impaired by any subtle or refined distinctions. Still, the mere fact that the same persons were directors of the corporation which made the lease and of that which took it is not of itself sufficient to avoid the contract at the instance of one or more stockholders against the will of the corporation. That fact alone might entitle either corporation to avoid the lease, but I apprehend it does not give the right to a stockholder. In the cases cited on behalf of the plaintiff, and in all

the cases I have met with, where contracts have been avoided on that ground, the relief was sought or assented to by the 'corporation.' There is a class of cases, to which those cited by the plaintiff's counsel belong, where the acts of the directors are fraudulent *and an injury to the corporate property*, in which it is held that an action may be maintained and an injunction awarded at the instance of an aggrieved stockholder. But this case does not belong to that class. The distinction between the two classes of cases is observed in *MacNaughton vs. Osgood* (41 Hun, 109).

There the action was brought by a stockholder of the defendant corporation to restrain the payment of salaries which the three trustees had voted to themselves as officers of the corporation. the court held that the contract was not void, but voidable only at the election of the corporation ; that the plaintiff as a stockholder could not maintain the action without showing dishonesty on the part of the directors *and an injury to the corporate estate* ; that it was not sufficient for him to show the fiduciary relations of the directors and that they had adopted the resolutions in which they were personally interested, as it was not clear from the simple fact that the directors voted to themselves salaries and received them that the corporation had been injured. At the close of the opinion LANDON, J., says :

'There is a plain distinction between a case in which the corporation may at its own option, avoid such a contract, and a case in which the corporation *from the fact that it is despoiled and in the hands of its spoilers*, ought to be adjudged to avoid it.'

(The opinion then considers the validity of a certain by-law and other matters not material to the subject in hand.)

**Burden v. Burden, 159 N. Y., 287, (affirming 8 A. D., 160: 1899)**

BARTLETT, J. :

\* \* \* \* \*

[The opinion begins with a consideration of the circumstances leading to the organization of the corporation and of the construction of the agreements under which it was organized, etc.]

The plaintiff claims that as the two companies had common directors, it was unlawful for them to deal with each other; also that the company was subjected to great loss in the use of the Hudson river ore, which was inferior in quality, and affected, in a marked degree, the finished products of the business.

The trial court found that James and Arts did not make these purchases of Hudson river ore to benefit themselves, or to build up and benefit the Hudson River Ore and Iron Company, nor were they made in bad faith or with any intent to defraud; that by the purchase of the Hudson river ore in the place of the same quantity of higher priced brown hematite ores a saving was effected from July 1st, 1883, to November 1st, 1889, of \$97,394.88, and that during the same period there was a saving of \$58,178.90 in manufacturing pig iron instead of purchasing it, if there was excluded from the cost of manufacture the proportionate share of the general expenses of the company which was charged to the blast furnaces. The trial court also found as a conclusion of law that the purchase of the Hudson river ore at its fair market value, as disclosed by the evidence, was not a wrongful or illegal act on the part of the Burden Iron Company or its trustees.

The question of fraud, or bad faith, is thus removed from the case, and we are to consider whether plaintiff was entitled to the injunction prayer for by reason of the fact that James and Arts were directors in both companies.

It is undoubtedly a well-settled rule of law that executory contracts entered into by corporations having common directors are voidable at the instance of either corporation, and the court will not inquire into the question whether or not it is beneficial to the corporation seeking to avoid it.

*This right is vested in the corporation and not in the individual stockholder.*

*A stockholder cannot enjoin the execution of a contract intra vires unless fraud is shown.*

Morawetz on Corporations (sec. 243) uses this language: 'So long as the agents of a corporation act honestly within the powers conferred upon them by the charter, they cannot be controlled. The individual shareholders have no authority to dictate to the company's agents what policy they shall pursue, or to impair that discretion which was conferred upon them by the charter.'

The rule is also laid down in *Leslie v. Lorillard* (110 N. Y., 532). Judge GRAY, speaking for the Court, said: 'In actions by stockholders, which assail the acts of their directors or trustees, courts will not interfere unless the powers have been illegally or unconscientiously executed, or unless it be made to appear that the acts were fraudulent or collusive and destructive of the rights of the stockholders. Mere errors of judgment are not sufficient as grounds for equity interference; for the powers of those intrusted with corporate management are largely discretionary.'

The plaintiff was not entitled to the injunction prohibiting further dealings with the Hudson River Ore and Iron Company.

The plaintiff is doubtless quite right when he insists that he has been ignored in the management of the Burden Iron Company, and has no control, save to vote his stock, over properties of great value in which his interest is nearly one-half, but he apparently fails to appreciate that his troubles are inherent to the situation.

The plaintiff is in the position of all minority stockholders, who cannot interfere with the management of

the corporation so long as the trustees are acting honestly and within their discretionary powers.

The court below has found that the trustees in this case so acted.

The judgment appealed from should be affirmed, with costs.

All concur.

Judgment affirmed.

[19 N. Y. 207.]

**Hoyt v. Thompson's Executor.**

[Syllabus.]

Although the charter of a corporation declares that its powers "shall be exercised by a board of directors", consisting of a specified number, yet the board may delegate its authority to agents, or to a quorum composed of less than a majority of the number. A by-law, therefore, declaring that the ordinary business of the corporation may be transacted by a quorum of five directors, the whole number being twenty-three, is a valid regulation.

A by-law of a corporation declared that five directors should be a quorum for the transaction of "ordinary business:" *Held*, that the general business of the corporation was embraced in the authority thus delegated, including as incident thereto, the power of pledging or assigning assets of the corporation for the purpose of securing a debt.

The pledge or assignment was of the principal part of the assets of the corporation to a creditor who was pressing for payment of a very large demand. It was made by the executive officers of the company, and was approved by the quorum of five directors. The design was not to go into insolvency, but to relieve the corporation from embarrassment, and enable it to continue its business: *Held*, that the transaction was included in the authority delegated to the five directors, and was to be deemed the act of the corporation.

A corporation may ratify the unauthorized acts of its agents which are within the corporate powers, and such ratification may, it seems, be inferred from acquiescence merely.

An averment in pleading that an agent acted by due authority, is sustained by proof of subsequent ratification.

\* \* \* \* \*

[The following statement of the law in the opinion of the Court delivered by Judge COMSTOCK, has become the basis of all subsequent decisions in this State.]

The first inquiry suggested by the facts stated is whether the by-law of the company authorizing a quorum of five directors, including the president, to trans-

act ordinary business, was a valid negotiation. We are clearly of opinion that it was. The charter of the company, it is true, declared that its powers should be exercised by a board of twenty-three directors, and it may well be conceded that in the absence of any different regulation, a majority of the whole number would be necessary to constitute a legal quorum for the transaction of any business whatever. But it would be a very extraordinary construction of the charter in this respect, to hold that the board of twenty-three directors, or a majority thereof, must meet and act whenever any corporate power was to be exercised, and that no delegation of authority could be made to subordinate agents, to committees, or to a quorum consisting of a smaller number.

This decision was applied to railroad corporations in the case of *Olcott v. Tioga Railroad Co.* (27 N. Y. 558), and to a manufacturing corporation in the case of *Sheridan Electric Light Co. v. Chatham National Bank* (127 N. Y. 517, 522), where the Court expressed itself, through Judge HAIGHT, as follows :

“The business of a manufacturing corporation must  
“be carried on by a board of trustees ; but such trustees  
“are empowered to appoint such subordinate officers  
“and agents as the business of the corporation shall  
“require. (1 R. S. 600, §1, subd. 5 ; 2 *id.* [7th ed.]  
“1531, §5.)

“Under this authority they may appoint an executive  
“committee of their own members, investing it with  
“power to transact the business of the company during  
“the interval between the meetings of the board of  
“trustees (*Olcott v. Tioga Railroad Company*, 27 N. Y.  
“546-557).

“Whether the executive committee may have power  
“to delegate its judgment and discretion it is not neces-  
“sary to now consider.”

[L. R. App. Ca. (1902), 83]

**Burland v. Earle**

Privy Council, November 9, 1901.

LORD DAVEY. \* \* \*

The action was commenced by the Respondents on the 7th December 1897. By their amended Statement of Claim they prayed for a declaration that the accumulation by the Defendants of a surplus or reserve fund was *ultra vires* and for an immediate division and distribution amongst the shareholders of all sums of money accumulated and retained as a reserve fund over and above the authorized capital stock of the Company and various other items of relief.

Their Lordships will confine their attention to the points which have been discussed on these appeals. These are (1) the formation of the rest or reserve fund (2) the investment of it (3) a *claim by the Respondents to treat Burland as a trustee of the plant and material of a certain insolvent company called the Burland Lithographic Company which he purchased at a sale by auction and re-sold at an enhanced price to this Company and to make him account to the Company accordingly for the profit made by the re-sale* (4) a question as to certain sums drawn as salaries by Burland the Appellant J. H. Burland.

\* \* \* \* \*

(1) It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so.

(2) Again it is clear law that in order to redress a wrong done to the Company or to recover moneys or damages alleged to be due to the Company the action should *prima facie* be brought by the Company itself.

These cardinal principles are laid down in the well-known cases of *Foss v. Harbottle*, 2 Hare, 461, and *Mozley*

*v. Alston*, 1 Ph., 790, and in numerous later cases which it is unnecessary to cite.

(a) But an exception is made to the second rule where the persons against whom the relief is sought themselves hold and control the majority of the shares in the Company and will not permit an action to be brought in the name of the Company. In that case the Courts allow the shareholders complaining to bring an action in their own names. This however is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress and it is obvious that in such an action the Plaintiffs cannot have a larger right to relief than the Company itself would have if it were Plaintiff and cannot complain of acts which are valid if done with the approval of the majority of the shareholders or are capable of being confirmed by the majority.

(b) The cases in which the minority can maintain such an action are therefore confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A familiar example is where the majority are endeavoring directly or indirectly to appropriate to themselves money property or advantages which belong to the Company or in which the other shareholders are entitled to participate as was alleged in the case of *Menier v. Hooper's Telegraph Works* (L. R., 9 Ch. 350).

(c) It should be added that no mere informality or irregularity which can be remedied by the majority will entitle the minority to sue if the act when done regularly would be within the powers of the Company and the intention of the majority of the shareholders is clear. This may be illustrated by the judgment of Lord Justice MELLISH in *Macdougall v. Gardiner* (1 Ch. D. 13 at p. 25).

(3) There is yet a third principle which is important for the decision of this case. Unless otherwise provided by the regulations of the Company a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a

particular interest in the subject matter of the vote. This is shown by the case before this Board of the *North-West Transportation Company Limited v. Beatty* (12 A. C. 589). In that case the resolution of a general meeting to purchase a vessel at the vendor's price was held to be valid notwithstanding that the vendor himself held the majority of the shares in the Company and the resolutions was carried by his votes against the minority who complained.

If these elementary considerations are borne in mind the solution of the principal questions arising in these appeals will not present any real difficulty.

\* \* \* \* \*

[54 Atl. Rep. 1.]

**J. Aspinwall Hodge et al. vs. United  
States Steel Corporation et al.**

[Court of Errors and Appeals, N. J.; November  
Term, 1902.]

[Syllabus.]

1. At a meeting of the stockholders of a corporation owners of shares are under no disability to vote because they are also directors of the corporation. They do not vote in their fiduciary capacity, but like other stockholders, in the right of the shares held by them.

2. At a duly convened meeting of stockholders they may lawfully enter into or authorize a contract between the company and a third party, in which directors are personally interested, if it is done by them with notice of such interest.

3. The general doctrine is well established in this State, that facts known, which are sufficient to put a party upon inquiry are sufficient to charge him with all such knowledge as he would have acquired by a proper inquiry in the ordinary course of business.

4. The rule that directors cannot lawfully enter into a contract, in the benefit of which even one of their number participates without the knowledge and consent of the stockholders, is the settled law of this State.

5. Such a contract is voidable at the option of the corporation, but is not void *per se*. When the facts are disclosed to the stockholders, it may be subsequently ratified by them.

\* \* \* \* \*

The opinion of the Court was delivered by  
VAN SYCKEL, J.

The subject matter of this appeal is an order granted by the Court of Chancery at the instance of the complainants, restraining the defendants from executing, issuing, delivering or receiving any bond or mortgage, under certain resolutions of the stockholders of the United States Steel Corporation, passed

May 19, 1902, providing for the reduction of \$200,000,000 of its preferred stock and the retirement thereof out of bonds or the proceeds of bonds.

\* \* \* \* \*

The Board of Directors of said corporation, having resolved that it would be advisable to decrease the capital stock of the corporation to the extent of 2,000,000 shares, and to retire them by means of an issue of bonds, called a meeting of the stockholders to be held on the nineteenth day of May, 1902, in pursuance of and as required by Section 27 of the General Corporation Law, and by the Act of 1902, for the purpose of voting upon the proposed plan for the purchase and retirement of that amount of preferred stock and the issue of five per cent. bonds.

Prior to the notice of this meeting the directors had entered into a tentative contract with Messrs. J. P. Morgan & Co., bankers, under date of April 1, 1902, by which said bankers agreed with the Steel Corporation that \$100,000,000 face value of the new bonds would be taken and paid for, of which \$80,000,000 would be paid for by a like amount of preferred stock taken at par, and \$20,000,000 would be paid in cash.

To guarantee the performance of this contract a syndicate was formed by J. P. Morgan & Co., the members of which actually deposited with that firm \$80,000,000 of preferred stock to be used in the performance of the contract.

The effect and purport of this agreement is that the bankers agreed to buy from the Steel Corporation at least \$100,000,000 of five per cent. bonds and to pay therefor \$20,000,000 in cash and \$80,000,000 in preferred stock at par, with an option to purchase the remaining bonds if the stockholders did not do so, and in consideration of this undertaking the bankers were to receive a commission of four per cent. on \$100,000,000 and contingently a commission of four per cent. on any additional amount that might be taken at par by the stockholders or the bankers.

This contract with the banker was to be subject to the approval of the stockholders.

At the stockholders' meeting on the nineteenth of May, 1902, duly convened, the resolution to retire the preferred stock, and the resolution to adopt the bankers' contract were separate and distinct, and were voted upon and passed as separate and distinct resolutions.

The shareholders could have adopted the first and rejected the latter.

There was in attendance at the meeting in person or by proxy, of over seventy-three per cent. of the outstanding preferred stock, and over seventy-eight per cent. of the outstanding common stock. More than 99 83/100 per cent. of the stockholders at such meeting, present either in person or by proxy, voted in favor of both resolutions, and only seventeen one-hundredths of one per cent. voted against them.

The by-laws of the corporation contained the following provision :

" The Board of Directors in its discretion may submit any contract or act for approval or ratification at any annual meeting of the stockholders, or at any meeting of the stockholders called for the purpose of considering any such act or contract, and any act or contract that shall be approved or ratified by the vote of the holders of a majority of the capital stock of the company which is represented in person or by proxy at such meeting (provided that a lawful quorum of stockholders be there represented in person or by proxy), shall be as valid and as binding upon the corporation and upon all the stockholders, as though it had been approved or ratified by every stockholder of the corporation."

This by-law cannot amplify the powers of the corporation or operate to validate any act *ultra vires* of the corporation, but it enabled the stockholders, by a majority vote to ratify any contract which the entire body of stockholders, or the corporation might lawfully make.

Both resolutions therefore received more than the vote required by the 27th section of the corporation act, and by the by-law of the company.

If all the shareholders had intended to convert their preferred shares into five per cent. bonds, they would

of course have voted for the conversion resolution, and have rejected the bankers' contract. In a scheme involving such an enormous amount of capital, and affecting thousands of shareholders, it could not reasonably have been supposed that all would prefer to accept the five per cent. bonds, and it was therefore the exercise of a prudent foresight that prompted them, in order to assure the successful execution of the plan, to secure the co-operation of bankers who could command millions of capital.

When the subject-matter of the litigation was before this Court at the June Term, 1902, in the case of *Berger vs. The United States Steel Corporation*, it was expressly declared :

1st. That the act concerning corporations, as revised in 1896, authorizes corporations formed under it to retire shares of its preferred stock, purchased with bonds or the proceeds of bonds issued for that purpose, the provisions of sections 27 and 29 being complied with.

2d. The manner in which a duly authorized plan is to be carried through is part of the business of the corporation, and, in the absence of fraud or bad faith, is not the subject of judicial control to any greater extent than other business of the corporation. *The Court cannot substitute its judgment for that of the directors and majority stockholders, and say that a less expensive plan could be successfully adopted.*

These questions, therefore, are not open to controversy in this case, in so far as the cost or wisdom of the plan is concerned.

There is an entire absence in the case of anything to show a taint of fraud, or an attempt to conceal from the shareholders any fact which should have influenced their action.

That the entire proceeding was conducted with good faith, without concealment, and with fairness to both parties, is evinced by the fact that during all the litigation which has ensued, under promotion of a share owner, who did not attend the meeting, not one of the vast number of shareholders who were present in person or by proxy, comprising men of great business capacity, interested to the extent of millions of dollars

in the conversion plan, has questioned its propriety, or expressed a desire, so far as appears, to recede from it.

The contract with the bankers was submitted to the stockholders without comment, and as stated in the resolutions, of which a copy was tendered to the stockholders, "was not finally to become or to be operative until after approval thereof by the stockholders in special meeting assembled."

The *first reason* to be considered, upon which the complainants rely to maintain their injunction is, that *the action of the directors in passing the resolutions for the plan of conversion, and approving the banker's contract, was fraudulent and void*, because fifteen or more of the twenty-four members of the board of directors were interested in the syndicate which was formed to assist in carrying out the banker's contract and to share its profits; and that the plan was never properly and legally ratified by the two-thirds vote of the stockholders required by the corporation act, inasmuch as the votes upon the stock held or controlled by the banker's firm and members of the syndicate must be counted to make up the necessary two-thirds, and without those votes the requisite number did not approve the reduction of stock.

*The insistence that the votes of members of the syndicate, who were also directors of the company, cannot be lawfully counted in order to constitute a two-thirds vote in favor of the resolution to reduce the amount of preferred stock, is without any foundation in reason or in law.*

They voted upon that resolution, not as directors, not in their fiduciary capacity, but solely in the right of the shares of stock held by them. A most valuable privilege, which attaches to the ownership of stock in a corporation, is the right to vote upon it at any meeting of stockholders. *As to that resolution considered by itself, as stockholders, they owed no greater duty to their co-stockholders than those stockholders owed to them.*

Like other stockholders, they had a right to be influenced by what they conceived to be for their own

interest, and they cannot lawfully be denied that right, nor can it be limited or circumscribed by the fact that they occupied the position of directors in the company.

With respect to the banker's contract a very different rule applies.

The rule that directors cannot lawfully enter into a contract, in the benefit of which even one of their number participates without the knowledge and consent of the stockholders, is so firmly entrenched in our jurisprudence that it is not open to debate.

It is emphasized and enforced in the following among many other cases.

<i>Staats vs. Bergen</i> .....	2 C. E. G.	554
<i>Wimans vs. Crane</i> .....	7 Vr.	394
<i>Stroud vs. Consumers' Water Co.</i> .....	27 Vr.	422
<i>Gardner vs. Butler</i> .....	3 Stew.	702
<i>Guild vs. Parker</i> .....	14 Vr.	430
<i>Stewart vs. Lehigh Valley R. Rd.</i> ....	9 Vr.	505
<i>Traction Co. vs. Board of Works</i> .....	27 Vr.	431

The rule is imbedded in our jurisprudence, and it cannot be too strongly stated, or too vigorously applied. But in the cases cited the contract was made by the trustee without the knowledge or consent of the *cestui que trust*, and without subsequent ratification or adoption by which the vice in it could be cured.

The object of the rule is to prevent directors from secretly using their fiduciary position for their own emolument, and not to impair the right of stockholders to enter into any lawful engagement with a full disclosure of the facts.

Stewart vs.  
Lehigh R. Co.

In *Stewart vs. Lehigh Valley R. R. Co.*, *supra*, Mr. Justice DIXON, in delivering the opinion of this Court, says:

"After an examination of all the cases cited, as also such others as I have found, and a careful consideration of the principle, and the results of regarding and disregarding it, I have come to the conviction that the true legal rule is, that such a contract is not void but voidable, to be avoided at the option of the *cestui que*

*trust*, exercised within a reasonable time; I can see no further safe modification or relaxation of the principle than this."

It is a settled rule of corporation law that the personal interest of directors renders a transaction voidable at the option of the stockholders, and not void *per se*.

Under the declaration of this Court in the case last cited the shareholders may within a reasonable time after the disclosure to them of the interest of a director elect to avoid the contract, but if a reasonable time is allowed to elapse without exercising such option, during which the position of directors becomes so changed that it would be inequitable to vacate the engagement, equity would refuse to interpose.

A fortiori, when the contract is entered into by the stockholders with the directors, or when the stockholders expressly authorize the directors to enter into a contract, when the stockholders have notice of the directors' interest, the agreement will be unassailable in the absence of actual fraud, or want of power in the corporation.

In this case not only was the banker's contract made with J. P. Morgan & Co., and approved by a two-thirds' vote of the shareholders, with knowledge that J. P. Morgan was one of the directors of the Steel Corporation, *a fact which they may be presumed to have known*, but also in the circular letter accompanying the call of the stockholders' meeting to be held on the 19th day of May, it was expressly stated as follows :

"To further the success of the plan there has been formed a syndicate, including some directors, which will receive four-fifths of the four per cent. compensation to be paid under the contract with Messrs. J. P. Morgan & Company, mentioned in the notice of stockholders' meeting."

Gale v. Morris

The deliverance of this Court with respect to the sufficiency of notice in *Gale vs. Morris*, 3 Stew., 285, is as follows :

“ If the party notified make reasonable investigation, he obtains actual knowledge of these facts ; if he chose not to make it, he is charged constructively with knowledge of them. The rule merely prohibits him from taking advantage of his own imprudence to the detriment of another. But as to the matters that lie within the notice, the principle assumes another form. It charges the party with knowledge of those matters so far as reasonable inquiry has not dissipated their credibility. If he is unwilling to act upon the facts as the notice presents them, then the law demands that he shall make proper examination, and upon the result of that examination he may safely stand. *Williamson vs. Brown*, 15 N. Y., 354. But if he prefer not to examine, it must be because he is satisfied to act as if the matters disclosed in the notice were true, and he cannot afterwards complain if his rights are made to rest upon them so far as they are true. The information given by the notice is equivalent to that obtained by inquiry.”

Haslett v.  
Stephany.

In *Haslett vs. Stephany*, 10 Dick, 68, Vice-Chancellor PITNEY said :

“ For these reasons I think that the facts above stated, which were clearly within defendants’ knowledge, were sufficient to put him upon inquiry. The general doctrine that facts which are sufficient to put a party upon inquiry are sufficient to charge him with all such knowledge as he would have acquired by a proper inquiry in the ordinary course of business is, as I take it, thoroughly established in this State. It was so held in the Court of Appeals in the case just cited (6 C. E. Gr., 463), and that case followed *Hoy vs. Bramhall*, 4 C. E. Gr., 563, in the same Court. The doctrine of these cases has always been followed in New Jersey.”

The cases in England are to the like effect

*Phosphate of Lime Co. vs. Green*, 7 C. P., 43.

*May vs. Chapman*, 16 M. & Welsby, 355.

The stockholders of the company are therefore chargeable with express notice that some directors

were interested in the banker's contract, and by reasonable inquiry at the meeting of May 19th they could have ascertained the names and number of such directors.

They signified by their votes that they approved the contract with such full knowledge.

In *Durfee vs. Old Colony R. Co.*, 5 Allen, 230, Chief Justice BIGELOW says : *Durfee vs. Old Colony.*

“ It may be stated as an indisputable proposition, that every person who becomes a member of a corporation aggregate by purchasing and holding shares agrees by necessary implication that he will be bound by all acts and proceedings, within the scope of the powers and authority conferred by the charter, which shall be adopted or sanctioned by the vote of the majority of the shareholders of the corporation, duly taken and ascertained according to law. This is the unavoidable result of the fundamental principle that the majority of the stockholders can regulate and control the lawful exercise of the powers conferred on a corporation by its charter.”

In the case of the Steel Corporation the right of the majority does not rest upon implication. In the by-laws adopted by the stockholders, in pursuance of authority given by the act of incorporation, such power is expressly given to the majority.

In *Leavenworth vs. Chicago Railway Co.*, 134 U. S., 688, it was held that the action of the stockholders validated the contract where nine out of thirteen directors were personally interested.

In the cases of *Nye vs. Storer*, 168 Mass., 53, and *Bjorngaard vs. Goodhue County Bank*, 49 Minn., 483, a like infirmity in contracts was held to be eliminated by the vote of a majority of stockholders.

The like view is expressed by the Court of Appeals of Maryland in *Shaw vs. Davis*, 28 Atl. Rep., 619, as follows :

“ It may be stated, as the result of all the authorities that whenever any action of either directors or stockholders is relied on in a suit by a minority stockholder for the purpose of invoking the interposition of a Court of equity, if the act complained of be neither

*ultra vires*, fraudulent or illegal, the Court will refuse its intervention because powerless to grant it, and will leave all such matters to be disposed of by the majority of the stockholders in such manner as their interest may dictate, and their action will be binding on all, whether approved of by the minority or not."

The healing effect of the ratification by stockholders upon a voidable contract entered into by directors is fully recognized in *Grant vs. United Kingdom Ry. Co.*, 40 Ch. D., 135.

In the case *sub judice*, the contract was in effect, made between the stockholders themselves and J. P. Morgan & Co., and it cannot be successfully assailed, without maintaining that stockholders are without capacity to make a valid contract with the directors of their company.

It would be manifestly contrary to fair dealing and good faith to permit stockholders to invite directors to enter into an engagement, and after the directors had put themselves in a position in which the contract could be enforced against them, to permit the stockholders to deprive them of the benefits of it.

In my investigation no case has been found which will justify such a result.

In the proper application of a legal rule, it cannot be necessary in order to do justice to one party to do manifest injustice to the other. Such inequity would condemn the application of the rule, not the rule itself.

On the ground which has been discussed, upon the facts presented, the complainant's case is without support in law. He made no inquiry, did not attend the meeting, and now attempts to deprive the two-thirds of the stockholders who did attend the May meeting of the benefit of a contract which they then approved, and which, as has been held in the *Berger* case, the corporation had power to make.

As was declared in that case (citing *Ellerman vs. Chicago Junction Co.*, 49 N. J. Equity, 217) individual stockholders cannot question, in judicial proceedings, corporate acts of directors if the same are within the powers of the corporation, and in furtherance of its

purposes ; are not unlawful or against good morals, are done in good faith and in the exercise of an honest judgment.

Much less can a shareholder challenge like action taken by a majority of his co-stockholders.

*The other objections urged as to the want of conformity by the defendant corporation with the requirements of the act of 1902 have been duly considered, and are deemed to be without merit.*

There is no ground presented by the case, or agitated in the briefs of counsel, which will justify the interposition of a court of equity to arrest the proposed action of the defendants.

The decree below should be reversed and the injunction dissolved, with cost in this Court and in the Court below.

[141 Mass. 496-9 ; 6 Northeastern, 745.]

**Kelly v. Newburyport & A. H. R. Co.**

2. RATIFICATION—NOTES TO DIRECTORS—VOIDABLE ONLY.

A horse railroad company, through its directors, made a contract with one G., to build a road for a certain price in money and stock, and B. and C. became sureties upon the bond of G. G. failed to perform his contract, and the board of directors called on the sureties, themselves directors in the company, to finish the road, with notice that they would be held liable to the company for all damages that might accrue to the company by their default. The sureties proceeded to finish the road according to the contract, in which they originally had no interest. The price was fair and reasonable; the road was well built; the advancements made by them were in consequence of the notice of the directors to them; and they acted without fraudulent design to obtain any pecuniary benefit for themselves from said contract. The act of the directors in the premises was under authority of a general vote of the stockholders of the company authorizing them to make a settlement of the contract, and certain notes were given by way of such settlement. After giving the notes the company operated the road for a number of years, paid interest upon the notes, and did other acts tending to show that it recognized the notes as liabilities of the company. *Held*, that the notes had been ratified, or their voidability waived, and that an action might be maintained upon them to recover their value against the company.

3. PRINCIPAL AND AGENT—CONTRACT—RATIFICATION OF—WHAT CONSTITUTES.

In order to make a valid ratification it is not necessary that the principal should not only know all the facts, but also the legal effect of the facts, and then, with a knowledge of both law and facts, have ratified a contract by some independent and substantive act. It is sufficient if a ratification is made with a full knowledge of all the material facts.

C. ALLEN, J. The first ground of defense is that by virtue of St. 1871, c. 381. § 6, the defendant was forbidden to build its road until a certificate had been filed in the office of the secretary of the commonwealth, signed and sworn to by the president, treasurer, clerk, and a majority of the directors, stating that the whole amount of the capital stock had been unconditionally subscribed for by responsible parties, and that 50 per cent. of the par value of each share of the same had been actually paid into its treasury in cash. It appeared by the auditor's report that such a certificate was filed in season, but he received evidence to show, and found as a fact, that 50 per cent. of the par value of each share had not been paid in, though the whole of the capital stock had been duly subscribed for, and more than 50 per cent. of the whole amount of it had been paid in at the time of the making of the contract for the construction of the road. Under these circumstances, the defendant contends that it had no power to enter into a contract for the construction of its road; that the act was *ultra vires*; that the unanimous action of the stockholders would not cure the taint; and that all promises to pay for work and materials in building the road, and all notes given therefor, are void and incapable of ratification, and that it cannot now be held responsible therefor, although for nearly 10 years it was held, enjoyed, operated, and taken the earnings of the road so built for it, and paid the interest on the notes. In reference to this ground of defense, it was sufficient to say that, according to cases heretofore decided, it has been declared to be unavailable. It was not intended by the legislature to allow corporations to escape from their just debts in this manner. *First Nat. Bank of Salem v. Almy*, 117 Mass. 476; *Augur Steel Axle Co. v. Whittier*, *Id.* 451; *Whitney v. Wyman*, 101 U. S. 392. See, also, *Davis v. Old Colony R. R.*, 131 Mass. 260; *Monument Nat. Bank v. Globe Works*, 101 Mass. 57; *Gold Min. Co. v. National Bank*, 96 U. S. 640; *National Bank v. Matthews*, 98 U. S. 621; *Harris v. Rinnels*, 12 How. 79; *O'Hare v. Second Nat. Bank*, 77 Pa. St. 96.

The defendant then contends that the notes in suit cannot be enforced because they were given to its own directors in payment for the construction of the road by them, and are now held by the plaintiff subject to all defenses which might have been made to a suit upon them by the payees. *Upon this point the only question properly before us is whether there was sufficient evidence to warrant the jury in finding a ratification of the notes by the corporation. The presiding judge assumed that the notes were originally void, and submitted to the jury the single question of ratification. Being of the opinion that there was sufficient evidence to warrant the verdict on the question of ratification, we have no occasion to consider whether it might not also have been proper to submit to the jury the question of the original validity of the notes under proper instructions.*

\* \* \* \* \*

*The second request sought to incorporate into the doctrine of ratification a new element: namely, that, in order to make a valid ratification, the principal must have not only known all the facts, but also the legal effect of the facts, and then, with a knowledge both of the law and facts, have ratified the contracts by some independent and substantive act. This request also was properly refused. It is sufficient if a ratification is made with a full knowledge of all the material facts. Indeed, a rule somewhat less stringent than this may properly be laid down when one purposely shuts his eyes to means of information within his own possession and control, and ratifies an act deliberately, having all the knowledge in respect to it which he cares to have. Combs v. Scott, 12 Allen, 493, 497; Phosphate of Lime Co. v. Green, L. R. 7 C. P. 43, 57.*

[168 Mass., 53, 46 N. E., 402.]

**Nye vs. Storer.**

[Supreme Judicial Court, 1897.]

Appeal from supreme judicial court, Suffolk county.

Bill by William F. Nye, as a stockholder, against Herman B. Storer and others, officers and directors of the Onset Bay Grove Association, a corporation, to cancel a lease by the corporation to defendants. Bill dismissed, and plaintiff appeals. Bill dismissed.

KNOWLTON, J. If we assume, in favor of the plaintiff, without deciding, that he has alleged such facts in the conduct of the corporation and its directors as would enable him, as a stockholder, to obtain relief if it appeared that the acts complained of were illegal, we come to the substance of the charges of illegality.

(The opinion here discusses the question of illegality).

The only other ground of objection to the lease is that it was fraudulent. But in this part of the case there are no fraudulent acts charged. It is not charged that the price to be paid was inadequate, or that the directors or corporation acted otherwise than as they deemed for the best interest of the stockholders. The lessees assumed all risks, and agreed to give the corporation one-half of the net income. The effect of the lease upon the corporation property not included in the lease was to be considered, as well as other questions of policy. That the plaintiff is prevented from receiving a portion of the surplus earnings and actual profits of the company does not show fraud. It may well be for its pecuniary benefit, and that of every stockholder in the corporation, that a portion of the earnings will be used by the lessees in accordance with the terms of the lease. A general charge of fraud, without stating facts in which the fraud consists, is not enough (*Nichols vs. Rogers*, 139 Mass., 146 29 N. E. 377 ; *Other v. Smurthwaite*, L. R. 5 Eq. 437-441).

That the lease runs to persons who are directors of the corporation is a suspicious circumstance, which calls for careful scrutiny, but of itself, it does not necessarily render the transaction void (*Union Pac. R. Co. v. Credit v. Mobilier of America*, 135 Mass. 367-376; *Kelley vs. Railroad*, 141 Mass. 496-499, 6 N. E. 745, and cases cited). Such a transaction may be made in good faith for the best interests of the corporation. *It may be avoided or may be ratified by the corporation.* Although there is constructive fraud in a contract made by all the acting directors of a corporation with themselves as individuals, which renders the contract voidable, there is no such fraud in a stockholder's voting upon a transaction between the corporation and himself (*Transportation Co. v. Beatty*, 12 App. Cas. 589; *Gamble v. Water Co.* 123 N. Y. 91, 25 N. E. 201; *Bjorngaard v. Bank*, 49 Minn. 483, 52 N. W. 48; see, also, *Oil Co. v. Marbury*, 91 U. S. 567; *Gas Co. v. Berry*, 113 U. S. 322, 5 Sup. Ct. 525; *Conyngham's Appeal*, 57 Pa. St. 474. But such transactions will be set aside upon slight evidence of actual fraud.

In the present case the substance of all the charges is that the making of the lease was an evasion of the charter, and, it being established that such a lease might lawfully be made under the charter, no valid objection to the transaction is stated. It is not charged in the bill, nor contended in argument, that the directors, in making the lease, intended to obtain a pecuniary advantage for themselves to the detriment of the other stockholders. Bill dismissed."

[52 Northw. Rep. 48.]

**Bjorngaard, et al., v. Goodhue County  
Bank, et al.**

[Supreme Court of Minnesota, May 5, 1892.]

RIGHTS OF STOCKHOLDERS—SALE OF PROPERTY TO  
CORPORATION.

Stockholders in a corporation are not disqualified to vote upon a matter coming before a stockholders' meeting by the fact that they may have a personal interest in the matter, as upon a proposition to ratify a purchase of property from themselves which they as directors had assumed to make.

[Syllabus by the Court.]

Appeal from district court, Goodhue County ; CROSBY, Judge.

Action by Thor R. Bjorngaard and others against the Goodhue County Bank and others. From a judgment for defendants, plaintiff's appeal. Affirmed.

GILFILLAN, C. J. The defendant bank is a banking corporation. The defendants Sheldon, Perkins, Featherstone, Brooks, Boxrud and William and Frederick Busch, and the plaintiff Hoyt, were, at the times hereinafter mentioned, and now are, its directors. The director defendants were and are stockholders, owning a large majority of the stock. The plaintiffs are stockholders. The defendant stockholders owned a lot and building. At a directors' meeting on July 7, 1890, all the directors being present, it was resolved, all the directors except Hoyt, who protested, voting in the affirmative, that the corporation purchase at a price specified said lot and building, and on July 11th the owners executed a conveyance to the bank. The action is brought to set aside the transaction, and to prevent the funds of the bank being used to complete the purchase, and also to prevent a ratification by the stockholders, a meeting of whom

had been called for the purpose; or, rather, to prevent such ratification by votes of defendants. There is no doubt that, within the rule in *Rothwell v. Robinson* 39 Minn. 1, 38 N. W. Rep. 772, the plaintiffs may bring such an action without first applying to the corporate authorities to bring it. The directors against whom complaint is made are not only a majority of the directors, but they own a majority of the stock, so that any application either to the board of directors or to the body of stockholders to bring the action would be equivalent to asking the alleged wrongdoers to bring suit in the name of the corporation against themselves. The law does not require of the minority stockholders to do so absurd a thing as a condition of seeking relief against the wrongful acts of the directors and majority stockholders.

The court below decided the case in favor of the defendants on the proposition that, although the act of the board of directors was voidable, it was not *ultra vires*, and was capable of ratification; and where a majority of the stockholders have power to ratify the unauthorized act of the directors, courts will not interfere. We see no reason to think this purchase was *ultra vires*,—that the corporation had not power to make it. And, that being so, it may be conceded that the board of directors had authority to make a purchase for the corporation. And it is undoubtedly true that, where a corporation had power to do a certain thing, though the authority to do it is not in the directors, the stockholders may ratify their act if they assume to do it on behalf of the corporation.

But this transaction is not voidable because *ultra vires*,—because there was no authority in the directors to purchase; but it is voidable under the rule that one having authority from another to purchase or sell for him cannot purchase from nor sell to himself. To do so is in law a fraud. The rule is absolute, and the matter of fraud in fact is immaterial. The party for whom the purchase or sale is made need not allege nor prove fraud or injury, but may disaffirm without taking any risk. The rule

is inflexible in order to prevent fraud on the part of one holding a fiduciary relation, by making it impossible for him to profit by it, thus removing temptation from his way. This court has steadily adhered to and applied the rule since it first enunciated it in *Baldwin v. Allison*, 4 Minn. 25, (Gil. 11.)

But in all cases of the kind the principal may, with full knowledge of the facts, ratify what has been done. The act of the defendant directors was a violation of this rule, and the purchase was not binding on the corporation until ratified. The question is therefore presented under the allegation and relief asked in the complaint, had the defendants a right to vote as stockholders at the stockholders' meeting called for the purpose upon the question of ratification? While stockholders in a corporation owe the duty of good faith to each other in the management of the affairs of the corporation, they do not stand to each other in a fiduciary relation within the rule we have stated. They are not trustees nor agents for each other in the matter of voting upon any proposition that may come before a meeting of the stockholders. In voting, each must be guided by his own judgment as to what is for the best interest of the corporation. The fact that he may have a personal interest, separate from the others or from that of the corporation in the matter to be voted upon, does not affect his right to vote. It is not to be understood that the majority stockholders may use their power of voting for the purpose of defrauding the minority. It was said in *Gamble v. Water Co.*, 123 N. Y. 91, (25 N. E. Rep. 201), in which the right of a stockholder in such a case to vote was affirmed: 'In such cases it may be stated that the action of the majority of the stockholders may be subjected to the scrutiny of a court of equity at the suit of the minority shareholders.' And in *Transportation Co. v. Beatty*, L. R. 12 App. Cas., 589, in which the same thing was held, it was said, in effect, that in such case the ratification must not be brought about by unfair or improper means, nor

to be illegal or fraudulent or oppressive towards those shareholders who oppose it.

A rule excluding stockholders from the right to vote merely because they might be personally interested to vote in a particular way, contrary to the interests of the other stockholders, would be likely to lead to great confusion. The rule laid down in the two cases cited is sufficient to secure the exercise of the good faith which one stockholder owes to the others. Judgment affirmed."

[146 Mass. 495 ; 16 N. E. 426.]

**Dunphy v. Traveler's Newspaper Ass'n.**

[Supreme Judicial Court, 1888.]

KNOWLTON, J. The plaintiff brings this bill as a stockholder in the defendant corporation, in behalf of himself and such other stockholders as may join therein, alleging that Roland Worthington, one of the defendants, is the president and treasurer of said corporation, and is, and for a long time has been, the owner or controller of a majority of the shares of its capital stock, and, by means of his ownership and control, has chosen such persons to be directors as he has seen fit, and has improperly used and invested large sums of the money of the corporation in certain specified ways, and has kept other large sums of its money on hand, drawing no interest ; and has improperly received large amounts as his salary as president of the corporation, and as rent of a building owned by him and occupied by it ; and has prevented the making of dividends upon the capital stock, and has otherwise improperly managed the affairs of said corporation, to the great damage to the plaintiff and other stockholders.

\* \* \* \* \*

(The opinion here discusses the prayers of the bill)

Courts of equity are swift to protect helpless minorities of stockholders of corporations from oppression and fraud of majorities. But the legal relations into which the members of a corporation enter require them to seek redress of supposed wrongs done them as stockholders, from its officers, and from the corporation itself, before applying elsewhere. Misconduct in dealing with a corporation, or in the management of its affairs, can effect its members only through the corporation itself. The wrong, in such a case, is done primarily to the corporation. It is the duty of its directors, or other man-

aging officers, to protect it from those who would do it injustice, and to seek compensation for any injury which it receives.

Stockholders in a corporation impliedly agree, when they join it, to act in the corporate business through officers chosen to represent them, or by vote at meetings of the members regularly called ; and so, if they deem themselves aggrieved as shareholders by the dealings of others with it, or by the acts of its managers, they are bound to seek their remedy through corporate channels—*First*, by application to the officers in charge ; and, failing there, secondly, to the corporation itself, at a meeting of its members. If they can obtain justice at the hands of neither, the courts are open for their relief. It would be contrary to the fundamental principles of corporate organizations to hold that a single shareholder can at any time launch the corporation into litigation to obtain from another what he deems to be due it, or to prevent methods of management which he thinks unwise.

Intelligent and honest men differ upon questions of business policy. It is not always best to insist upon all one's rights ; and a corporation, acting by its directors or by vote of its members, may properly refuse to bring suit which one of its stockholders believes should be prosecuted. In such a case the will of the majority must control. It is only when the action of a corporation in refusing to proceed at the request of a stockholder is fraudulent as against him, or in disregard of his rights, that he can maintain a suit in his own name in the corporate right.

The court cannot interfere with the management of corporations in matters which are properly within their discretion, so long as their discretion is fairly exercised ; *and it is always assumed, until the contrary appears, that they and their officers obey the law, and act in good faith towards all their members.* Even when their acts are *ultra vires*, or otherwise illegal, a complaining mem-

ber must first seek his remedy within the corporation.

The only exception to the rule that the stockholder must apply to the directors, and also, if need be, to the corporation for the redress of a wrong done it, before he can sue in a court of equity for himself, and in behalf of the other stockholders, is when it appears that such application would be unavailing to protect his rights. *Brewer v. Theatre*, 104 Mass. 378; *Allen v. Wilson*, 28 Fed. Rep. 677; *Haves v. Oakland*, 104 U. S. 450; *Detroit v. Dean*, 106 U. S. 537, 1 Sup. Ct. Rep. 560; *Dimpfell v. Railway Co.*, 110 U. S. 209, 3 Sup. Ct. Rep. 573; *Foss v. Harbottle*, 2 Hare, 461. That may happen when the directors themselves are the wrong-doers, or are in fraudulent combination with them, or when the corporation is controlled by them, or when it is necessary that action should be taken too speedily to leave time for a corporate meeting of stockholders.\*

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\* *Samuel v. Holliday* (Mr. Justice MILLER) Woolw 400; 21 Fed. Cases 306-312:

“If a stockholder is aggrieved by the refusal of the board of directors to accept his views, his remedy is to unite with other stockholders, and change those directors. But, if irreparable mischief to his interests may ensue in the meantime, equity will administer preventive justice until such time as the will of the body of stockholders can be ascertained.”

[78 Md. Rep. 308, s. c., 28 Atl. 619.]

### Shaw vs. Davis

(1894, Court of Appeals); McSHERRY J. (ROBINSON, C. J. BRYAN, BRISCOE, PAGE and FOWLER, JJ., of the Court).

(The opinion first discusses the facts in considerable detail and certain points as to the pleading).

The case, then, before us is that of a minority stockholder filing a bill in his own behalf, and in behalf of others who may subsequently join him, to restrain by injunction the majority stockholders of one railroad company from leasing, except with the leave of a court of equity, and upon the terms which it may prescribe, the road of another railway company, in which latter company the majority stockholders are the same persons who are the majority stockholders in the proposed lessee company; and also praying for an account between the two companies of antecedent financial transactions.

Naturally, the inquiries which such a case suggests at the very outset are—First, what jurisdiction has a court of equity to control the internal management of a corporation at the instance of a minority stockholder? and, secondly, in what manner does the circumstance that the majority of the stock is held by the same persons in both the companies, affect the question of jurisdiction?

*And, first, it may be stated, as the result of all the authorities, that whenever any action of either directors or stockholders is relied on in a suit by a minority stockholder for the purpose of invoking the interposition of a court of equity, if the act complained of be neither ultra vires, fraudulent, nor illegal, the court will refuse its intervention because powerless to grant it, and will leave all such matters to be disposed of by the majority of stockholders in such manner as their interests may dictate, and their action will be binding on all, whether approved of by the minority or not.*

"In this country," said the late Mr. Justice MILLER, in speaking for the supreme court of the United States in *Hawes v. Oakland*, 104 U. S. 450, "the cases outside the federal courts are not numerous, and, while they admit the right of a stockholder to sue in cases where the corporation is the proper party to bring the suit, they limit this right to cases where the directors are guilty of a fraud, or a breach of trust, or are proceeding *ultra vires*." MacDougall  
v. Gardiner.

And so, in *MacDougall v. Gardiner*, 1 Ch. Div. 14, JAMES, L. J. said :

"I think it is of the utmost importance in all these companies that the rule, which is well known in this court as the rule in *Mosley v. Alston*, 1 Phil. Ch. 790, and *Lord v. Miners Co.*, 2 Phil. Ch. 740, and *Foss vs. Harbottle*, 2 Hare, 461, should be always adhered to ; that is to say, that nothing connected with internal disputes between the shareholders is to be made the subject of a bill by some one shareholder in behalf of himself, and others, unless there be something illegal, oppressive, or fraudulent,—unless there is something *ultra vires* on the part of the company, *qua* company, or on the part of the majority of the company, so that they are not fit persons to determine it ; but that every litigation must be in the name of the company, if the company really desire it. *Because there may be a great many wrongs committed in a company, there may be claims against directors, there may be claims against officers, there may be claims against debtors, there may be a great variety of things which a company may be well entitled to complain of, but which, as a matter of good sense, they do not think it right to make a subject of litigation ; and it is the company as a company which will make anything that is wrong to the company the subject of litigation, or whether it will take steps to prevent the wrong being done.* \* \* \* Everything in this bill, so far as I can see, if it is a wrong, is a wrong to the company. Whether it ought to have been done, or ought not to have been done, depends on whether it is for the good of the company it should have been done, or for the good

of the company it should not have been done; and, putting aside all legality on the part of the majority, it is for the company to determine whether it is for the good of the company that the things should be done, or should not be done, or left unnoticed."

In the same case MELLISH, L. J., after observing that very often, in companies, things are done which ought not to be done, proceeds :

" Now, if that gives a right to every member of the company to file a bill to have the question decided, then, if there happens to be a cantankerous member, or one member who loves litigation, everything of this kind will be litigated; whereas, if the bill must be filed in the name of the company, then, unless there is a majority who really wish for litigation, it will not go on. In my opinion, if the thing complained of is a thing which, in substance, the majority are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority has the right to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then, ultimately, the majority gets its wishes. *Is it not better that the rule shall be adhered to that, if it is a thing which the majority are the masters of, the majority, in substance, shall be entitled to have their will followed?* If it is a thing of that nature, it only comes to this, that the majority are the only persons who can complain that a thing which they are entitled to do has been done irregularly; and this is what, as I understand, was decided by the cases of *Mozley v. Alston* and *Foss v. Harbottle*. In my opinion this is the rule to be maintained." See, also, *Gray v. Lewis*, 8 Ch. App. 1050.

*Secondly, the fact that the same persons hold the majority of the stock in both companies, does not, of itself, enlarge the Court's jurisdiction.*

The act complained of furnishes the test of jurisdiction, and it must be *ultra vires*, fraudu-

lent or illegal. Nothing short of this will suffice. This is true even in a case where directors, and not stockholders, do the act complained of. *Booth v. Robinson*, 55 Md. 441. And for stronger and more obvious reasons it is also true in a case where stockholders themselves act directly. They are not trustees or *quasi* trustees for each other. Even a director is not, strictly speaking, a trustee (*Spering's Appeal*, 71 Pa. St. 11; *Smith v. Anderson*, 15 Ch. Div. 247).

In *Pender v. Lushington*, 6 Ch. Div. 70, JESSEL, M. R., in speaking of the rights of a stockholder, said :

"I cannot deprive him of his property, though he may not make use of the property in the way I approve. This is really the question, because, if these stockholders have a right of property, then I think all the arguments which have been addressed to me as to the motives which induced them to exercise it, are entirely beside the question."

*Pender v.  
Lushington.*

Then, after referring to a decision by MELLISH, the Master of the Rolls proceeded :

"In other words, he (MELLISH, J.) admits a man may be actuated in giving his vote as stockholder by interests adverse to the interests of the company as a whole. He may think it was for his particular interest that a certain course may be taken which may be, in the opinion of others, adverse to the interests of the company as a whole ; but he cannot be restrained from giving his vote in what way he pleases, because he is influenced by that motive. *There is, if I may so say, no obligation on a shareholder of a company to give his vote merely with a view to what other people may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interests. This being so, the arguments which have been addressed to me, as to whether or not the votes which were given would bring about the ruin of the company, or whether or not the motive was an improper one which induced these gentleman to*

*give their votes, or whether or not their conduct shows a want of appreciation of the principles on which this company was founded appear to me to be wholly immaterial."*

And, in *Manhattan El. R. Co.'s* case, 11 Daly, 516, the Court says :

" It is argued that, if common directors are disqualified from acting, so are common stockholders incapable to ratify agreements between their companies, and that the holder of one share of stock in each company could prevent any action at a stockholders' meeting relating to the two companies, no matter how advisable that action might seem to the holder of every other share. I do not say that the disqualification extends to a shareholder. I see no reason why it should. The disqualification rests entirely on the fiduciary relation. A shareholder is trustee for nobody. He has only his own interests to look after as such stockholder. Closely connected, undoubtedly, he is in practice with every other stockholder, but he holds no such fiduciary relation to the corporation as stockholder as he holds as director." *Beach, Corp. c. 13 § 247.*

Accepting these propositions as the fixed and settled law, it remains now to inquire whether the proof sustains the allegations of the bill, and brings the case within the legal principles to which reference has just been made. If the Messrs. Davis and Mr. Elkins selected, as alleged, an improper location for the Piedmont & Cumberland road, and improperly constructed that road, so that it would be ruinous to operate it, and if they did this with a view of throwing the heavy cost operating it on the West Virginia Central, *it is difficult to assign a reason for such singular conduct. On its face the allegation is, to say the least, improbable. Those gentlemen owned over 30,000 shares of the 55,000 issued shares of the West Virginia Central Company, while they owned but 7,295 shares of the Piedmont & Cumberland road ; and that they would purposely and designedly wreck their larger and more*

*valuable holdings in the West Virginia Central merely for the purpose of realizing an income from a smaller and dependent road, in which their aggregate shares were not one-fourth of the amount owned by them in the main enterprise, is quite incomprehensible. Certainly, no motive for such strange course has been shown. But, apart from the improbable character of the allegation, it is not supported by the evidence.*

(The Court here further discusses the evidence.)

(The opinion then takes up consideration of evidence)

What we have said in considering the subjects just discussed applies equally to so much of the prayer of the bill as relates to the relief sought by way of account; and, without repetition, we need only add that the plaintiff has failed to support by evidence the averments upon which the jurisdiction to grant that particular relief depends. There is no pretense that the two companies had not the necessary powers, under their charters and under the laws, to enter into the business relations out of which these questions of account arose. The transactions themselves were not illegal, and, however erroneous the accounts may be conceded to be, when considered from the standpoint of a professional accountant, there has been literally nothing adduced to show that the alleged errors were fraudulently or designedly committed, with a view of benefiting the stockholders of Piedmont & Cumberland Company at the expense of the stockholders of the West Virginia Central Company. Nor does the making of a lease by the Piedmont & Cumberland road to the West Virginia Central Company necessarily depend upon the state of antecedent accounts between the two companies. Whatever unadjusted or erroneously adjusted accounts there may be can as readily be balanced and settled after, as before, a lease has been executed.

And if the proposed lease be not *ultra vires* or unlawful or fraudulent, no court, at the instance of a minority stockholder, or at the in-

stance of any one else, has the power or the right to restrain the majority from dealing with the property as they may deem most advantageous to their own interests. *Any other doctrine would put it in the power of a single stockholder, owning but one share out of many hundreds, to transfer the entire management of a corporation to a court of equity, and would effectually destroy the right of the owners of the property to lawfully control it themselves. It would make a court of equity practically the guardian, so to speak, of such a corporation, and would substitute the chancellor's belief as to what contracts a corporation ought, as a matter of expediency, or policy, or business venture, to make, instead of allowing such questions to be settled by the persons beneficially interested in the property. No such arbitrary or dangerous power has ever been claimed by any court, and if laid claim to, it would never be tolerated in a free government.*

The injunction granted on March 14, 1891, prohibited the making of a lease upon the terms of 60 per cent. of the gross earnings, or any other lease, until the further order of the court. Apart from all questions of *ultra vires*, illegality, and fraud, this power, thus assumed, undertook to reserve to the court the authority to prescribe the terms of any lease, because it prohibited the making of any lease without the court's leave. When the terms are not agreed to, the conditions not named, and the covenants not formulated, what authority exists in the chancellor to assume in advance that an act *ultra vires*, or that fraud or illegality, will be attempted? In the case at bar the lease which was actually prepared under the circumstances we have already stated at large—which are a flat negation of any fraud or secrecy—made no provision for a 60 per cent. but for a 63 per cent. proportion of the gross earnings, and there is nothing to show, even if we had the right to go into an examination of the subject, that such a proportion of the gross earnings would be an unfair or inadequate

rental. As the court had no power to decree a lease, so it had no power to prescribe the terms of one. It could prohibit the doing of an act *ultra vires*, illegal, or fraudulent. Beyond that it could not go. As no such act was before it, it did right in dissolving the injunction, and in dismissing the bill. For the reasons we have given we will affirm the decree appealed from. Decree affirmed, with costs above and below.

[112 Cal., 53 ; 44 Pac. 333]

**San Diego, &c. R. Co. v. Pacific Beach Co.**

(1896, Supreme Court of California ; McFARLAND, J. with TEMPLE and HENSHAW, JJ. concurring)

1. That a majority of the directors in one corporation were also directors of another corporation does not render a contract between the two corporations, entered into through the directors, absolutely void.

2. A land company, engaged in platting and selling land, contracted with a railway company to pay it a certain sum in installments, in consideration that the railway company should run a certain number of trains daily for two years to the land company's land. The contract was executed on the part of the railway company, and several of the installments paid by the land company. At a stockholders' meeting of the land company, the contract was affirmed by a majority of the stockholders. *Held*, that the land company, even though it could have avoided the contract in the first instance, could not defeat a recovery of the unpaid installments on the ground that, at the execution of the contract, the two corporations had directors in common.

Department 2. Appeal from superior court, San Diego County ; GEORGE PUTERBAUGH, Judge.

Action by the San Diego, Old Town & Pacific Beach Railroad Company, a corporation, against the Pacific Beach Company, a corporation. From a judgment for plaintiff, and from an order denying a new trial, defendant appeals. Affirmed.

McFARLAND, J. This is an action upon two promissory notes made by defendant to plaintiff—one for \$15,000, and the other for \$1,500 ; the latter being for interest due upon said first-named note. Judgment went for plaintiff, from which, and from an order denying a new trial, defendant appeals.

\* \* \* \* \*

The main contention of appellant for a reversal arises out of these facts : The respondent had five directors,

and the appellant nine ; and at the time the contract was made four of the directors of the appellant were also directors of the respondent, and it is also claimed that, before the completion of the contract, a fifth director of appellant—D. C. Reed—became a director of respondent. A majority of the directors of both corporations were also stockholders in both, and the contention of appellant is that, because there were common directors of the two corporations as aforesaid, therefore the contract was absolutely void, and incapable of ratification. Respondent contends that, upon these facts, the contract was, at the most, only voidable, and that the appellant ratified it. Appellant also contends that, even though ratification were possible, there was none. In this case there is no actual fraud, either alleged or found ; and this distinguishes it from many of the cases cited by appellant. The contract seems to have been a fair, open one, and carried into effect before the eyes of all persons interested. Neither is there any question of *ultra vires* ; and this also distinguishes the case from cases cited by appellant. The court found that appellant's charter expressly gave it the power to make such a contract. See, also, on this point, *Vandall v. Dock Co.*, 40 Cal. 83. The contention, therefore, at this point of the case, is that the mere fact that there were common directors, as above stated, of the two corporations at the time of the contract, makes it absolutely void ; and this contention cannot be maintained.

*Where two corporations, through their boards of directors, make a contract with each other, the directors who are common to both are not within the rigid rule of the cases which hold that one who acts in a fiduciary capacity cannot deal with himself in his individual capacity, and that any contract thus made will be declared void, without any examination into its fairness, or the benefits derived from it to the cestui que trust. Two corporations have the right, within the scope of their chartered powers, to deal with each other ; and this right is certainly not destroyed or*

*paralyzed by the fact that some, or a majority, of the directors are common to both. Of course, if such directors should wrongfully and willfully use their powers to the prejudice of one of the corporations, their action, if not acquiesced in, and if contested at the proper time, could be avoided, as in any other case of actual fraud. But such common directors owe the same fidelity to both corporations, and there is no presumption that they will deal unfairly with either. Therefore, their acts as such common directors are not void.*

There are abundant authorities to this proposition, but it is hardly necessary to refer to any other than that of *Pauly v. Pauly*, decided by this court (107 Cal. 8, 40 Pac. 29), and the cases there cited. In that case the court, in its opinion, says:

“The stumbling block in this case, however, seems to have been the double relation of agency of Collins, Dare, and Harvermale being at the same time officers and directors in both corporations,”

and quotes approvingly from *Mining Co. v. Senter*, 26 Mich. 73, and *Leavenworth Co. Com'rs v. Chicago R. I. & P. Ry. Co.*, 134 U. S. 688, 10 Sup. Ct. 708, which cases strongly declare the rule above stated. The conclusion reached is correctly condensed in the syllabus, as follows:

“The fact that some of the directors of the bank were also directors of the cable company does not prevent them from being distinct corporations, who have the right to contract with each other in their corporate capacities; and, if the relation of the parties has not been abused, it constitutes no bar to a recovery of moneys advanced by the bank and used for the benefit of the cable company.”

We will notice one or two other recent authorities to the same point. In *Coe v. Railway Co.*, 52 Fed. 543, Judge PARDEE says:

*Coe v. Railway Co.* “That the East & West Railroad Company could lawfully contract with the Cherokee Iron Works, although all the stockholders of the one were also stockholders of the other, in the absence of fraud and misrepresentation, is indisputable; nor would the fact

that the two corporations had substantially the same directors, who were the active agents negotiating the contract, render it void,—at worst, only voidable, but subject to ratification.”

In *Jesup v. Railroad Co.*, 43 Fed. 483, the validity of a lease between two corporations in which there were common directors was involved; and Justice HARLAN held (we quote, for brevity, from the syllabus, which is correct) as follows:

“The contract by which the Dubuque Company leased the Cedar Falls road would not have been void, even if the majority of the directors of that company had been personally interested in the Cedar Falls Company. It would have been simply voidable at the election of the Dubuque Company, or, in a proper case, at the suit of its stockholders; and that election must have been exercised, or suit brought, within such time as was reasonable, taking into consideration all the facts and circumstances of the case.”

In the notes to section 658, Cook, Stock, Stockh. & Corp. Law (3d Ed.), there are many cases cited on the subject. They are not all in perfect harmony, but they abundantly warrant the statement in the text that “this class of contracts certainly are not void.” See, also, *Booth v. Robinson*, 55 Md. 419; *Kitchen v. Railroad Co.*, 69 Mo. 224.

[43 Fed. Rep. 483.]

**Jesup v. Illinois Cent. R. Co.,**

[Circuit Court, N. D. Illinois, 1890.]

HARLAN, J.

[The pertinent portion of the opinion begins at page 498 of the report and is as follows:]

Looking at all the facts and circumstances, we are of opinion that the directors of the Dubuque Company, including those who, at the time were holders of the bonds and stocks of the Cedar Falls Company, and expected to become interested in constructing the Cedar Falls road to Mona, were not guilty of actual fraud in leasing the Cedar Falls road upon the terms prescribed in the instrument of September 27, 1866. The lease seems to have been made in the exercise of an honest judgment upon their part as to what, under all the circumstances, the best interests of both companies absolutely demanded. The excess, if any, of the rents agreed to be paid by the Dubuque Company, over what the business of the Cedar Falls road justified, is not such as to raise a presumption of fraud upon the part of those causing the lease to be made. At most, it would only show error of judgment in respect to a matter of business.

Recurring to the main proposition advanced by the Dubuque Company, we next inquire whether the lease of 1866 should be adjudged void upon grounds of public policy arising out of the relations of trust which Jesup and others, at the time, held to that company. Without stating in detail the proceedings of the various meetings of the board of directors of the Dubuque Company at which the subject of the lease was mentioned or discussed, it is sufficient to say that the lease was approved by nine directors. Of that number, five, Morton, Knox, Stout, Schuchardt, and Robb, had no interest whatever in the Cedar Falls Company as stockholders, bondholders, or creditors, and all of that five, unless Robb was an exception, were large holders of the stock of the Dubuque Company. Of the remaining directors, Jesup, Frost, Smith and

James, were at the time holders of outstanding bonds and stock of the Cedar Falls Company, the value of which would be increased by the completion of the road. Indeed, it is a fair inference from the testimony that the directors of the Dubuque Company who were not interested in the Cedar Falls Company looked to Jesup, James, Frost, and Smith, or some of them, to provide the means for the completion of the Cedar Falls road to the state line. It is also true that the four directors last named expected to become holders of the bonds and stock issued on account of the additional road to be constructed from Waverly to Mona. While two of that number, Jesup and James, were large holders of the stock of the Dubuque Company, their interests in the Cedar Falls Company were greater than in the other company. It is not, therefore, to be questioned that, when the lease of 1866 was made, Jesup, Frost, Smith, and James were in a position where their private interests in connection with the Cedar Falls Company might conflict with their duty as directors of the Dubuque Company. They were on both sides of the question as to the lease of the Cedar Falls road upon the terms stipulated. As stockholders and bondholders of the Cedar Falls Company, they were interested in binding the Dubuque Company to pay the highest possible rent. As directors of the Dubuque Company, their duty was to protect it against burdens that could not be prudently or safely assumed, and to advance its interests in every proper way.

These facts being admitted or proven, the inquiry yet remains, to what extent do they affect the validity and binding force of the lease or justify a decree of cancellation? The attention of the court has been called to *Wardell v. Railroad Co.*, 103 U. S. 651, 658. That was a case of a contract authorized by railroad directors pursuant to a scheme by which they were to share with the other party large sums to be realized from the contract. The court said :

“It is among the rudiments of the law that the same person cannot act for himself, and at the

same time, with respect to the same matter, as the agent of another whose interests are conflicting.  
\* \* \* The law, therefore, will always condemn the transactions of a party on his own behalf, when, in respect to the matter concerned, he is the agent of others, and will relieve against them whenever their enforcement is seasonably resisted. Directors of corporations, and all persons who stand in a fiduciary relation to other parties, and are clothed with power to act for them, are subject to this rule. They are not permitted to occupy a position which will conflict with the interest of parties they represent and are bound to protect. They cannot, as agents or trustees, enter into or authorize contracts on behalf of others for whom they are appointed to act, and then personally participate in the benefits. Hence all arrangements by directors of a railroad company, to secure an undue advantage to themselves at its expense, by the formation of a new company as an auxiliary to the original one, with an understanding that they, or some of them, shall take stock in it, and then that valuable contracts shall be given to it, in the profits of which they, as stockholders in the new company, are to share, are so many unlawful devices to enrich themselves to the detriment of the stockholders and creditors of the original company, and will be condemned whenever properly brought before the court for consideration."

The case from which the above extract is made, and others of like character, are cited as requiring a decree canceling the lease in question as void upon grounds of public policy.

*We do not think that the cases referred to justify such a decree in this case.* A contract, in the name of a corporation, by its board of directors, is not void, if otherwise unassailable, simply because some of the directors, constituting a minority, used their position with the effect, or even for the purpose, of advancing their personal interests to the injury of the company they assumed to represent. The lease here in question, as we have seen, was approved by the nine directors of the Dubuque Company, five of whom had no personal ends to subserve by imposing upon the company

a lease that was unreasonable or harsh in its terms. On the contrary, as already stated, at least four of that five were holders of the stock of the Dubuque Company, and therefore interested to guard it against unnecessary or improper burdens. We need not inquire as to the extent of their information touching the facts bearing upon the question of the proposed lease. It is sufficient to say that they approved it, and that their approval was not, so far as the record shows, obtained through misrepresentation or concealment by their co-directors, who, in view of their personal interest in the Cedar Falls Company, ought not to have participated in deciding the question of lease or in the making of the lease. An instructive case upon this point is *U. S. Rolling Stock Co. v. Atlantic & G. W. R. Co.*, 34 Ohio, 450, 465. That was a suit upon a contract by a railroad company for rolling stock. The contract was approved by eight directors of the former company, (the whole number of directors being thirteen, but only eight acted), two of the number acting being also directors of and interested in the rolling-stock company. The defense was that the rent was not fair, nor the contract binding, because of the interest which some of the directors had in the rolling-stock company. The court said :

*U. S. Rolling  
Stock Co. v.  
Atlantic Co.*

“If it be granted that the confirmation of the contract by the defendant's board of directors, at the meeting of August 2, 1872, was voidable in equity at the election of the company, for want of the presence at that meeting of the board of a quorum of directors who were not directors of the plaintiff, it nevertheless appears that the board was composed of thirteen persons, a clear majority of whom were affected with no incapacity to act for the best interests of the company, and who sustained no fiduciary relation to the plaintiff whatever. This majority possessed ample power to restrain and control the action of the minority, and, if the contract was voidable at the option of the company, it had full power to express the company's election if it saw fit to avoid the contract. The fact that some of the persons composing this majority might vote with those who were members of both boards, and thereby create a majority in favor of the contract,

would in no wise affect the validity of the transaction, nor relieve the board from the duty to move in the matter if they desired the company's escape from liability. We have not, upon the most diligent research, been able to find a case holding a contract made between two corporations by their respective boards of directors invalid, or voidable at the election of one of the parties thereto, from the mere circumstance that a minority of its board of directors are also directors of the other company. Nor do we think such a rule ought to be adopted. There is no just reason, where a quorum of directors sustaining no relation of trust or duty to the other corporation are present, participating in the action of the board, why such action should not be binding upon the company, in the absence of such fraud as would lead a court of equity to undo or set aside the transaction. If the mere fact that the minority of one board are members of the other gives the company an opportunity to avoid the contract without respect to its fairness, the same result would follow where such minority consisted of but one person, and notwithstanding the board might consist of twenty or more. In our judgment; where a majority of the board are not adversely interested, and have no adverse employment, the right to avoid the contract or transaction does not exist without proof of fraud or unfairness; and hence the fact that five (out of thirteen) of the defendant's board of directors were members of the plaintiff's board, whatever may have been its opinion of defendant's right to disaffirm or repudiate the contract, if exercised within a reasonable time, did not disable the defendant from subsequently affirming the contract, if satisfied with its terms, or rejecting it if not; nor did it relieve it from the duty to exercise its election to avoid or rescind within a reasonable time, if not willing to abide by its terms. That it did not do this, nor take any steps towards its disaffirmance, but continued to act under it for nearly two years and a half, receiving the rolling stock, for the use of which it stipulated, and with which it operated the whole of its road for the whole of said period, making payment for such use in accordance with the rate fixed by the contractors, very clearly appears from the admitted facts. \* \* \* Hence the conceded facts clearly establish a ratification of the contract, and prevent the defense from denying its validity."

(The Court here considered a question of laches.)

The fundamental error in the argument for the Dubuque Company is in the assumption that the lease was absolutely void by reason of Jesup and other directors, who were interested in the Cedar Falls Company, having participated in the making of it. We have already indicated that, so far as the lease depended upon the action of the board of directors, its technical validity was placed beyond question by the approval of the majority of the directors, no one of whom then or ever had, so far as the record shows, any interest in the Cedar Falls Company.

*But to avoid misapprehension it is well to say that, in the judgment of the court, the lease would not have been void, even if a majority of the directors of the Dubuque Company occupied the same relations to the Cedar Falls Company that Jesup, James, Frost, and Smith did when the lease was made. It would, at most, have been simply voidable at the election of the Dubuque Company, or, in a proper case, at the suit of its stockholders, and that election must have been exercised or the suit brought, within such time as was reasonable, taking into consideration all the facts and circumstances of the case, including the nature of the property that was the subject of the lease. This last principle is illustrated in Oil Co. v. Marbury, 91 U. S. 587; Gas Co. v. Berry, 113 U. S. 322; and Leavenworth Co. v. Railway Co. 134 U. S. 688, 704; 10 Sup. Ct. Rep. 708 et seq.*

If, as was expected, the completion of the Cedar Falls road had been followed by the construction of roads in Minnesota connecting Mouna with the cities of St. Paul and Minneapolis, it may be that the lease of 1866 would have been very profitable to the Dubuque Company; in which event the courts would not have listened readily to an application by the Cedar Falls Company, after an unreasonable delay upon its part, to set aside the lease upon the ground that some of those representing it were at the time directors or stockholders of the Dubuque Company. So, if the lease had been in fact beneficial to the Dubuque Company, and if, for that reason, a majority of its directors and stockholders had desired to hold onto it, the

court would not necessarily, at the instance of a minority of the directors and a minority of the stockholders, have set it aside simply because some of its directors were at the time personally interested in promoting the welfare of the Cedar Falls Company; though the fact that such directors, constituting a minority of those acting, participated in making the contract, would cause the whole transaction to be closely scrutinized to the end that the rights of complaining stockholders, however small in number, might not be sacrificed by those who were bound to protect their interests. This shows that the lease was not void because of the relations of some of the directors of the Dubuque Company to the Cedar Falls Company, and that it would not have been absolutely void if the majority of such directors approving the lease held such relations to the lessor company.

*The rule is a wholesome one that requires the court, in cases of merely voidable contracts, to withhold relief from those who, with knowledge of the facts, or with full opportunity to ascertain the facts, unreasonably postpone application for relief. A contract not wholly invalid when executed, nor prohibited by law as relating to some illegal transaction, and which is therefore voidable only, may become, by the acts of the parties or by long acquiescence, binding upon them, especially where the nature of the property which is the subject of the contract is such that its value may be affected by its relations with other property of like kind, and by the changing business of the country. If, after the making of the lease of 1866, the directors and stockholders of the Dubuque Company had held a meeting, and, with knowledge of the facts, or with the means of ascertaining them, had declared, in words, that they would postpone application to have the lease set aside until they found out by operating the Cedar Falls road whether it was remunerative or not to them, or until the Illinois Central Railroad Company ceased to be under obligation to pay the stipulated rent, the case would not have been in point of law materially different from what it appears*

to be from the record before us. In so holding the court does not depart from the salutary principles announced in *Wardell v. Railroad Co.*, and approved in numerous cases. On the contrary, while that case holds that the law will always condemn the transactions of a party in his own behalf when in respect to the matter concerned he is the agent of others, it also declares that the court will relieve against them "whenever their enforcement is seasonably resisted." Seasonable resistance cannot be predicated of a case of a merely voidable contract, where the party complaining has not simply been silent for 20 years, but with knowledge of the facts, or with full opportunity to ascertain them, has enjoyed the fruits of the contract, and treated it as valid.

The court is of opinion, that, independently of any question as to the statute of limitations of Iowa, in which state the contract of lease was made, and was to be executed, the Dubuque Company is estopped to dispute the binding force of the lease of September 27, 1866, and, therefore, is not entitled to a decree of cancellation.

Other points than those above discussed are raised by the cross-bill, but they are not insisted upon in the printed arguments, and are not, in the judgment of the court, of sufficient importance to be noticed.

Let a decree be prepared and submitted to the court, recognizing the right of the plaintiff, Jesup, as surviving trustee in the mortgage of September 13, 1866, to receive the funds now in the registry of the Court, and containing such other provisions as may be proper and not inconsistent with this opinion.

JUDGE BLODGETT, who participated in the hearing and decision of this case, concurs in the views expressed in this opinion.

[112 F. R. 239.]

**Salem Iron Co. v. Lake Superior Consol.  
Iron Mines.**

[1901 C. C. A., Third Circuit. GRAY, Circuit Judge,  
with ACHESON and DALLAS, J. J., concurring.]

GRAY, CIRCUIT JUDGE.

\* \* \* \* \*

The plaintiff in error also, by its assignments and its argument before the court, strongly objected to what was said by the court below in regard to the legal effect of the fact that L. B. Miller, who executed the contract on the part of the defendant below, was also a member of the firm of Oglebay, Norton & Co., who, as agents for the plaintiff below, negotiated the contract in their behalf. As to this, the language of the court is as follows :

“ Comment has been made in this case upon the fact that Mr. Miller, the president of the Salem Iron Company was a member of the firm of Oglebay, Norton & Co., the selling agents of the plaintiff company, and that he signed the contract on behalf of the defendant company and on behalf of the selling firm as well. The fact that such was the case, and that he acted in a dual capacity—that is, acted on behalf of the Salem Iron Company and on behalf of the Lake Superior Consolidated Iron Mines,—does not necessarily and of itself invalidate the contract. The undisputed facts are that the firm of Oglebay, Norton & Co. were the owners of about one-fifth of the capital stock of the Salem Iron Company; that they were creditors of said company to the extent of some forty thousand dollars; that their commission on the Adams ore sale of five cents a ton was not fixed or determined by the price of the ore, and that the ore was sold at the regular market price for the year 1900 deliveries, and that the contract contained a provision that the price should be reduced to the lowest price at which the plaintiff company should sell to any one Adams ore during that year. Under these facts—which we do not understand are questioned—we are of opinion that, in view of the dual capacity in which Mr. Miller stood and acted, the contract, if valid in other respects, was not void, but void-

able only by the defendant company on this particular ground alone of Mr. Miller's dual relation, unless the jury should find that Miller took advantage of his position to impose upon the defendant company a contract which was unfair, oppressive, or fraudulent."

We think in this the court below correctly stated the law, and intelligently instructed the jury as to its application. *A contract so made was undoubtedly avoidable, and not void, unless the proofs should show that the conduct of the person acting in such dual relation amounted to fraud. This it might do if it were unfair and one-sided, and palpably to the advantage of one party alone to the contract.* The firm of Oglebay, Norton & Co., of which Miller was a member, were owners of one-fourth of the preferred stock of the defendant company, and were unsecured creditors of the company to the amount of \$45,000. Their interest in the contract in suit was a commission of \$1,500. *There is nothing, therefore, in the situation itself, that shows such a predominant interest in Miller as to suggest a motive on his part to deal to the disadvantage of the defendant company, and no effort was made by direct testimony to show that his conduct was unfair, one-sided, or oppressive.* Under the facts disclosed by the record, these matters were properly submitted to the jury.

[L. R. 40, Ch. Div. 135.]

**Grant v. United Kingdom Switchback  
Railways Company.**

(1888) affirming a decision of Mr. Justice CHITTY.

[Following is a complete report with the omission of head note.]

Thompson's Patent Gravity Switchback Railways Company was incorporated as a limited company on the 18th of November, 1887. The objects were, *inter alia*, to acquire the business of proprietors and licensors of gravity switchback railways carried on by Alfred Pickard and the Plaintiff, and among the objects specified were "(h) to promote any company for the purpose of acquiring any of the property or rights of this company, and generally for any purposes which this company may think conducive to its object." "(m) To sell the undertaking of the company, or any part thereof, for such consideration as the company may think fit, and in particular, for a consideration consisting in whole or in part of cash or shares or debentures of any other company having objects altogether or in part similar to those of this company."

The directors were not to be fewer than three or more than seven. Two directors were a quorum.

It was provided by art. 100 that "no director shall be disqualified by his office from contracting with the company either as vendor, purchaser, or otherwise, nor shall any such contract or arrangement entered into by or on behalf of the company with any company or partnership of or in which any director shall be a member or otherwise interested be avoided, nor shall any director so contracting, or being such member or so interested, be liable to account to the company for any profit realized by any such contract or arrangement by reason only of such director holding that office or of the fiduciary relation thereby established, but no such director shall vote in respect of any such contract or arrangement."

Art. 152 enabled the company by special resolution to alter all or any of the regulations of the company with certain exceptions not affecting the present case.

The plaintiff was a shareholder in Thompson's Company.

In September, 1888, the United Kingdom Switch-back Railways Company was registered as a company with limited liability. It was promoted by the directors of Thompson's Company, and was established for acquiring and carrying on the business of Thompson's Company so far as the United Kingdom was concerned.

There were five directors of Thompson's Company and six of the United Kingdom Company. Four persons were members of both boards.

On the 13th of September, 1888, a contract under the seals of the two companies was entered into by which Thompson's Company agreed to sell to the United Kingdom Company a large part of the property of the former company.

The Plaintiff brought this action against the two companies to restrain them from carrying the agreement into effect, and moved for an injunction.

On the 26th of September SIR JAMES HANNEN, as vacation Judge, ordered the motion to stand over till the Michaelmas sittings, the companies in the meantime undertaking not to act under the agreement, but they were to be at liberty to call meetings of their shareholders on the subject.

An extraordinary meeting of the shareholders of Thompson's Company was held on the 22nd of October, at which a resolution was proposed, "That the agreement dated the 13th of September, 1888, between" (the two companies) "be and the same is hereby approved and adopted, and that the directors be and are hereby authorized to carry into effect the same agreement." The notice summoning the meeting stated that this resolution would be proposed, but did not suggest any reason why the contract could not be carried into effect without the sanction of a general meeting.

The resolution was passed, but not in such a way as to make it a "special resolution."

On the 9th of November the motion for the injunction came on, and Mr. Justice CHITTY being of opinion that the Thompson's Company had adopted the contract, refused the injunction. The Plaintiff appealed.

*Gregson*, for the Appellant:—

*I contend that, so long as the articles were in force, a contract entered into by directors who were interested in the subject-matter, and therefore had no right to vote, was void, and a resolution confirming it was an alteration of the articles which could only be made by a special resolution. The agreement "was ultra vires the directors, was a nullity, and could not be ratified in this way: Clay v. Rufford (5 De G. & Sm. 768.)*

(COTTON, L. J.:—There it was held that the contract was beyond the powers of the company while the articles were in force. Here does not the resolution make the contract a contract by the company?)

The observation of Sir BARNES PEACOCK in *Irvine v. Union Bank of Australia* (2 App. Cas. 366, 374) is in my favour, though the passage on page 375 as to confirmation by a meeting is somewhat against me. The articles cannot be altered except by special resolution, and art. 100 is not to be read as saying that the directors interested shall not vote except with the sanction of a general meeting, but that they shall not vote without the sanction of a special resolution.

*The notice calling the meeting was insufficient, as contained no intimation that the contract was one into which the directors had no power to enter.*

*Romer, Q. C., and Eve, contra*, were not called upon.

COTTON, L. J.:

This is an appeal from a decision of Mr. Justice CHITTY refusing an injunction to restrain Thompson's Company and the United Kingdom Company from carrying into effect a contract for the sale of part of the undertaking of the former company to the latter. *The ground of the application was that the directors of Thompson's Company had no authority to enter into*

*the contract, as the articles prohibited a director from voting upon a contract in which he was interested, and here all the directors but one were interested. An application for an injunction was made in the Long Vacation, and ordered to stand over till the Michaelmas Sitting, the companies undertaking not to act upon the agreement in the meantime, but being left at liberty to call meetings of their shareholders with reference to the agreement. A general meeting of the shareholders of Thompson's Company was accordingly held, and passed a resolution approving and adopting the agreement, and authorizing the directors to carry it into effect. Mr. Justice CHITTY under these circumstances refused an injunction, and the Plaintiff has appealed.*

It was urged for the Appellant that the directors could not, being interested, make a contract which would bind their company, and that a general meeting could not, by a mere ordinary resolution, affirm that contract, for that this would be an alteration of the articles, which could only be effected by a special resolution. This is a mistake. The ratifying a particular contract which had been entered into by the directors without authority, and so making it an act of the company, is quite a different thing from altering the articles. To give the directors power to do things in future which the articles did not authorize them to do, would be an alteration of the articles, but it is no alteration of the articles to ratify a contract which has been made without authority.

*It was urged that the contract was a nullity and could not be ratified. That is not the case. There was a contract entered into on behalf of the company, though it was one which could not be enforced against the company. Article 100 prevented the directors from binding the company by the contract, but there was nothing in it to prevent the company from entering into such a contract. Two passages in *Irvine v. Union Bank of Australia* (2 App. Cas. 366) were referred to. Being in the same judgment, they must be taken together, and they appear to me to express what I have said—that power to do future acts cannot be given to direc-*

tors without altering the articles, but that a ratification of an unauthorized act of the directors only requires the sanction of an ordinary resolution of a general meeting, if the act is within the powers of the company.

*It was argued that the meeting was not good because the notice convening it gave no intimation that the contract was one which could not be carried into effect without the sanction of a general meeting. I think that the difficulty was sufficiently suggested by the mere fact of a meeting being called, for had it not been for the fact that the directors were interested, no meeting would have been necessary. But it is unnecessary to enter into that. A majority of a meeting called with due notice of the object for which it was called could make this a contract of this company; and it would be wrong for the Court to interfere with the proceedings of a general meeting as to an act within the powers of the company. It is clear that a contract of this nature was within the objects of the company, and the appeal, in my opinion, fails.*

LINDLEY, L. J. :—

The appellant contends that the company could not ratify this contract except by special resolution. In my opinion that contention is unfounded. There is a broad distinction between altering the articles and merely saying “this act was not authorized by the articles, but we will ratify it”. *The shareholders can ratify any contract which comes within the powers of the company, and this contract clearly does, for the articles expressly authorize selling any part of the undertaking of the company.*

*As to the alleged insufficiency of the notice calling the meeting, I have nothing to add to what has been said by the Lord Justice COTTON.*

BOWEN, L. J. :

*The contract here was entered into by directors who, being interested, had no right to vote. The company at a general meeting ratified and adopted it. The*

Appellant contends that this ratification was an alteration of the articles, and could only be made by a special resolution. That is not so. The company did not purport to alter the limits of the authority given generally by the articles to the directors. The articles limit that authority, but there is nothing in them to prevent the company from giving special power to the directors in a particular case as to a particular contract. *The company at a general meeting adopt this agreement, and make it their own. That is a ratification of an unauthorized act, not an alteration of the articles. As regards the notice calling the general meeting, I have nothing to add.*

[17 Misc. 220]

**The Socorro Mountain Mining Co.  
v. Preston.**

[1896 Supreme Ct., Albany Sp. Term]

Motion to discontinue action.

CHESTER, J. I think there is a failure to show by competent evidence in the moving papers that this action was not properly commenced in the name of the company by Mr. Darling, the former president.

I think, also, that while the directors might not properly vote to discontinue the action when they were personally interested in defendant, *yet that a majority of the stockholders could do so. The latter are not disqualified to vote on a question before the shareholders' meeting because of an interest in the result.* They have a right to represent their individual interest, and they are in no sense trustees or representatives of others. *Gamble v. Queens County Water Co.*, (123 N. Y. 91;) *Bjorngaard v. Goodhue Co. Bank*, (52 N. W. Repr. 48;) *Northwestern Transportation Co. v. Beatty*, (L. R. 12 App. Cas. 589.)

It is claimed that much of the stock which was voted upon by the stockholders at the last annual meeting had not been properly transferred upon the books of the company, which were in the hands of the prior president, Mr. Darling; but, upon his withholding the seal and the stock-book so as to prevent the transfer of the stock thereon, and the issue of new stock in time to permit it to be voted upon at the annual meeting, it was lawful for the directors to adopt and procure a new seal and a new stock-book to accomplish that purpose. *In re Argus Co.*, 138 N. Y., 557, 576.

It appears that this course was pursued, and that a majority of the stockholders, at the annual meeting, voted to discontinue this action, and, pursuant to this direction, the present president and secretary of the

company have made a consent to discontinue, upon which this motion is based.

I think that effect must be given to this consent. The action having been properly begun, however, and the plaintiff being insolvent, it should not be discontinued against the consent of the plaintiff's attorneys, without securing them for their lawful charges for their services and costs herein.

The motion to discontinue is granted, without costs, upon condition that the plaintiff's attorneys be first settled with and paid for their services and costs herein, and if there is a failure to agree upon the amount thereof a reference will be directed to determine the amount.

Motion granted, without costs.

[64 N. J. Law, 265; 45 Atlantic 622]

**Rankin v. Newark Library Ass'n.**

(1900, Court of Errors and Appeals).

2. The act of April 9, 1897, providing that in every library association every stockholder should have at least one vote for each share of stock held by him, became the absolute law of the Newark Library Association on being assented to by every stockholder therein, notwithstanding a provision in the special charter of the association which limited the voting power of shares held in blocks exceeding five by single owners.

(Syllabus by the Court.)

\* \* \* \* \*

DIXON, J. It appears that in January, 1899, there had been issued 1,138 shares of the capital stock of the association. Of these, 1,109 shares were represented and voted upon at the election of January, 1898, being the first election held after the passage of the act of 1897, and one of the stockholders owned and voted upon 443 shares at that election. If the votes then cast should be counted pursuant to the charter, one set of directors would be elected; if counted pursuant to the act of 1897, another set. The question was thus directly presented, which statute should prevail? Without a dissenting voice, the votes were counted under the act of 1897, and the directors so appearing to be chosen were declared to be elected, assumed their offices, and managed the concerns of the corporation during the succeeding year.

This course of events indicates the acceptance of the act of 1897 by every stockholder of the association. The assent of those present or represented at the election of 1898 is clear. *The assent of the absent holders of the remaining 29 shares is shown by their implied assent to the lawful action of those who attended, and also by their acqui-*

*escence during the year of 1898 in the control of the corporation by the directors chosen pursuant to that act. Indeed, none of those absentees yet appears to dissent.*

Thus, the statute, which on its enactment became perhaps only conditionally the law of this association,—the condition being the assent of all the stockholders,—became on fulfillment of that condition the absolute law of the corporation. *Jackson v. Walsh*, 75 Md. 304, 23 Atl. 778. The assent, once given, is irrevocable. Our conclusion, therefore, is that the act of 1897 rightfully prevailed in the election of 1899, that Mr. Riker and his associates were then lawfully elected, and that the judgment of the Supreme Court should be reversed.

**The Phosphate of Lime Company, Limited, v. Green, L. R. 7, C. P. 43.**

“WILLES, J. :

\* \* \* \* \*

It remains to consider whether or not the defendants have established the second branch of the alternative, viz., that the company did ratify and adopt the act of the directors. Now, the law with respect to ratification is clear, and applies equally to cases of contract and of tort. The principle by which a person on whose behalf an act is done without his authority may ratify and adopt it, is as old as any proposition known to the law. But it is subject to one condition: in order to make in binding, it must be either with full knowledge of the character of the act to be adopted, or with intention to adopt it at all events and under whatever circumstances. Is it proved that the company did intend to adopt the resolution of July, 1866? I may observe that the company at the end of 1866, or early in 1867 (I should say on the 6th of March, 1867), transferred its business to a new company called The Sombrero Company, upon a full consideration, and upon an arrangement by which the shares and capital of the Phosphate of Lime Company were to be absorbed into the new company, the shareholders in the former company becoming the holders of an equal number of shares in the Sombrero Company of 10£ each instead of 25£. That transfer which was so completed in March, 1867, was taken to be beneficial to the shareholders in the Phosphate of Lime Company, and there is no suggestion that any of them did object. The result was that the capital of the Phosphate of Lime Company was treated as the capital of the Sombrero Company, and the shareholders of the new company had all the benefit of the cancellation of the 400 shares referred to in the resolutions of the 10th and 24th of July, 1866. After that arrangement so made and

assented to, accounts were made out and brought before the shareholders of the Phosphate of Lime Company, at the meeting in March, 1867, accompanied by a report of the directors showing the reasons for the liquidation of the old company and the future prospects of the new company, and stating the capital of the new company to be 132,000£, and showing how that reduction had been effected, viz., partly by shares cancelled owing to the abandonment of the Lagrosan purchase, and partly by '*shares forfeited for nonpayment of calls,*' and partly by the reduction by the vendors of the Sombrero estate on the fully paid-up shares issued to them. It is clear, then, that the capital of the new company was reduced by, amongst other things, the 400 shares given up by the defendants on the compromise in July, 1866; and it is clear that they were intended to be included in the account submitted to the shareholders. It is said that the words '*shares forfeited for non-payment of calls*' do not properly describe the transaction. But, if it be intended to allege that there was improper concealment, that should have been relied on in the charge of fraud. It was involved in the abandonment of the Lagrosan purchase; it was connected with that purchase, and with the dealings with the persons who were instrumental in its negotiation. *I have no doubt whatever in my mind that those words did convey to every person interested in the Phosphate of Lime Company, who thought proper to make inquiry, sufficient information on the subject; and, with respect to those who did not think proper to seek information, the fact that they did not choose to inquire is strong evidence that they were satisfied to adopt the acts of the directors at all events and under whatever circumstances, and to take the benefit of the arrangement made by them in any form they thought proper. Looking to the fact that the transaction was not concealed, and that no shareholder was called at the trial to say that he did not know of it, I cannot doubt that the report and account did convey sufficient*

*information to the shareholders as to the cancellation of the 400 shares, and that there was no one shareholder who was ignorant of it. Further, it appeared that the defendants were credited in the books of the company, under date the 21st of August, 1866, 'By shares forfeited account, 4000£.' I believe that these are all the material facts. I think there was abundant evidence of a ratification, in the sense of an adoption of the act of the directors, either with knowledge of all the circumstances, or with an absolute intention to adopt it. All imputation of fraud was withdrawn. The transaction appears to have been a notorious one at the time. The Phosphate of Lime Company was in difficulties. A proposal was made for a transfer to the new Sombrero Company under circumstances under which every shareholder would naturally have his attention called to all the accounts and transactions of the company. Accounts were presented showing a forfeiture of shares with an amount set down as 4000£, a sum which was calculated to excite attention and inquiry. No shareholder is called to say that he was not aware of the transaction. All this shows clearly to my mind that there was a ratification. The transfer to the Sombrero Company involved a ratification, because it was founded upon a reduction of the capital, by means, amongst others, of the cancellation of these 400 shares. It would be a waste of time to refer to authorities to show that one who chooses to adopt the benefit of a transaction ought to be bound by it. The present case, however, goes much further than that, because, from the 6th of March, 1867, down to the 16th of May, 1870, when this action was brought, the shareholders have continued to receive dividends and to carry on the business of the Sombrero Company upon the footing of the dealings of March, 1867. That circumstance appears to me to add considerable weight to those I have already adverted to, and makes the case stronger against the company. I think it would be highly inequitable and unjust that the company*

should, after so long an acquiescence, be allowed to rip up the transaction and call upon the defendants to pay back the money, without at least restoring them the shares the cancellation of which formed the basis of the arrangement which was made by the resolution of the 10th of July, 1866, and confirmed by the resolution of the 24th."

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(KEATING, J., rendered an opinion in concurrence.)

BRETT, J. :

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It comes, therefore, to the question whether the act of the directors with reference to these 400 shares was ratified by the company. Now, in order to establish a case of ratification, it seems to me that it was not necessary to prove absolute knowledge on the part of every shareholder. As is pointed out by Lord ST. LEONARDS in *Spackman v. Evans* (1), *it was not necessary to show that every shareholder had actual notice.* 'It is said,' he observes, 'that the absent shareholders in this case are not bound by the arrangement unless the appellant can prove that every one of them knew the exact nature of the transaction. How can he prove this at the close of so many years? In *Brotherhood's Case* (2) it was held that they had notice,—not that, in point of fact, such notice was proved.' It is impossible to prove that every shareholder had notice or such a knowledge of the facts as amounts to notice. *It is sufficient to show that facts were made known to the shareholders, into the effect of which they might and ought to have inquired, and to which they ought to have objected at the time, unless they intended to adopt the transaction.* I think there was such evidence here. On the 5th or 6th of March, 1867, a meeting of the shareholders in the Phosphate of Lime Company was held for the purpose of considering the expediency of the absorption or transfer of that company to the Sombrero Company, with a diminished capital; and at that meeting a report was read in which it was stated, amongst

other things, that that diminution of capital had been effected 'partly by shares cancelled owing to the abandonment of the Lagrosan purchase, and partly *by shares forfeited for non-payment of calls.*' In order to effect a diminution of the capital, the shares under both these heads must have been cancelled. Mere forfeiture without cancellation would not have had that effect. The validity of the transfer or absorption adopted or authorized at that meeting has never been called in question. At the same meeting a copy of the accounts was put in and submitted to all the shareholders. That fact distinctly appears upon my notes. It was not like the case of the mere production of a ledger into which the shareholders could have no opportunity of looking at the time. *Unless the shareholders intended to adopt the transaction, they should have inquired into the circumstances, under which the cancellation took place. If they had done so, they would have been told that it was the result of a compromise.* The transfer having been made to the new company, dividends have been paid upon the smaller amount of capital, and consequently at an increased rate; and, things having continued in this state for two or three years, the company now seeks to recover from the defendants the sum advanced to them in 1866, and from which the directors had absolved them in consideration of the cancellation of the 400 shares; and this without giving them back the shares or paying them the dividends which would have accrued thereon. *Taking all these facts into consideration, it seems to me that there was abundant evidence to justify the jury in saying that the company (that is, the shareholders), with knowledge of all the circumstances, ratified and adopted what had been done by the directors, and that the plea of accord and satisfaction was proved.*

*Rule discharged."*

**Cole v. Reynolds, 18 N. Y., 74.**

Two firms, in each of which A was a partner, stated an account of their mutual dealings. The partners in the creditor firm, with the exception of A, who declined to be a plaintiff and was made a defendant, brought their action against the members of the debtor firm; *Held*, that upon proof of these facts the plaintiffs were entitled to judgment for the balance thus ascertained.

“ HARRIS, J. :

\* \* \* \* \*

The defendant's firm are indebted to the plaintiff's firm upon an account stated and settled between them. This fact, standing alone, would have entitled the plaintiffs to maintain an action at law. But there is another fact in the case, which, upon a technical rule peculiar to the common law, would have defeated such an action. One of the individuals composing the plaintiff's firm is also a member of the defendant's firm. A man cannot sue himself; and as, at common law, all the members of a firm must unite in bringing an action, it follows that in such a case no action at law could be sustained.

But in equity this technicality does not stand in the way of justice. It is enough, there, that the proper parties are before the court. They may be plaintiffs or defendants, according to circumstances, but, being before the court, it will proceed to pronounce such judgment as the facts of the case require. This latter rule is obviously the dictate of common sense. So far as I know, it prevails everywhere else except at the common law.

Indeed, equity, like the law of Scotland, and the systems of continental Europe, goes farther, and treats the copartnership as a distinct existence, having its own distinct rights and interests. ‘In all such cases,’

say STORY, 'courts of equity look behind the form of the transactions to their substance, and treat the different firms, for the purpose of substantial justice, exactly as if they were composed of strangers, or were in fact corporate companies.' (1 *Story's Eq. Jur.* sec. 680; *Story on Partnership*, sec. 235).

There is no difficulty, therefore, growing out of the fact that one of the parties is a member of both firms, in sustaining this action."

**First National Bank v. Wood, 128 N. Y. 35.**

PECKHAM, J. :

"One partner may give a note upon firm matters to another partner in the same firm, and the holder may maintain an action at law upon it without an accounting. (*Townsend v. Goewey*, 19 Wend. 424; *Crater v. Binninger*, 45 N. Y., 545; see, also, *Cole v. Reynolds*, 18 *id.* 74.)

Here there was an accounting, the notes having been given in acknowledgment of the debt then existing and being in the hands of third persons, no question can arise in the law of partnership relating to the so-called anomaly of one person suing himself. But the case of *Cole v. Reynolds* (*supra*), shows there is no difficulty even there where the case is that of two firms with one or more common members."

[114 F. R. 491]

**Windmuller v. Standard Distilling & Distributing Co.**

[1902 Circuit Court N. J.]

In Equity on rule to show cause against issuance of injunction.

KIRKPATRICK, District Judge. The complainants are the holders of certain shares of the first and second preferred stock of the Spirits Distributing Company, a corporation organized under the laws of the state of New Jersey, upon which the Standard Distilling & Distributing Company have guaranteed a dividend of 6 per cent. upon the first preferred, and 2 per cent. upon the second preferred, stock, during the existence of the said Spirits Distributing Company.

\* \* \* \* \*

It was proposed, about December, 1898, by one C. H. Eicks, that the stockholders of the Distributing Company should surrender their right to receive 7 per cent. on their first preferred stock and 6 per cent. on their second preferred stock, and that in lieu thereof they should agree to take 6 per cent. on their first preferred and 2 per cent. on their second preferred stock; and, as an inducement for them so to do, he proposed that the said stockholders should surrender to the Standard Distilling & Distributing Company, which had then but recently been organized with a capital of \$24,000,000, all of their common stock in the Distributing Company, which constituted a majority of the whole. He also said to them that in consideration thereof the Standard Company would guaranty the said dividends on the first and second preferred stock, as aforesaid, to the said stockholders during the existence of said Distributing Company. In order to carry out this plan, it became necessary that the charter of the Distributing Company should be amended, and the same was

accordingly done, with the consent of every one of its stockholders, including these complainants.

The agreement between the stockholders of the Distributing Company and the Standard Company was carried into effect. The old stock of the Distributing Company was surrendered to its officers, and new stock issued to the shareholders, upon which was stamped the guaranty of the Standard Company, and the common stock of the Distributing Company, being a majority of the whole, was transferred to the Standard Company. From January, 1899, to the date of the filing of the bill, the Standard Company has paid to the complainants the dividends upon their stock in the Distributing Company, as provided in the agreement. The Standard Company took charge of the business of the Distributing Company by qualifying and electing as directors a majority of the board. During the time of their control the business of the company has been successfully prosecuted, and its earnings have so largely increased that during the fiscal year ending June 30, 1901, it showed a profit of upwards of \$30,000. No complaint is made in the bill of the manner in which the property has been administered.

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At a meeting of the board of directors of the Distributing Company it was resolved that, in the judgment of the directors, it was most advisable and for the benefit of the corporation that it should be dissolved. In accordance with the general corporation act of New Jersey, a meeting of the stockholders was called to vote upon the propriety of adopting such a course. The prayer of the complainants' bill is that the Standard Company may be enjoined from voting upon its \$3,675,000, par value, common stock in favor of said proposition, because it has guaranteed the dividends on the stock of the Distributing Company as aforesaid, and that the Distilling Company be enjoined from voting upon its \$2,592,650, par value, of first and second preferred stock, which it has purchased and owns, because it also owns a majority of the stock of the Standard Company, which is the

guarantor thereof. *That is to say, however advisable and for the benefit of the corporation it may be that the same should be dissolved, yet it cannot be done because two-thirds of the stockholders whose votes are necessary to accomplish such result are disqualified from voting by reason of their interest in the cancellation of a guaranty which the complainants now conceive to be adverse to their interests. To carry the doctrine to its logical conclusion would be to hold that, if the guarantor's company and those who own a majority of the stock in the guarantor's company should also be the owners of all the stock in the guarantied company except one share, the owner of that one share could prevent the dissolution of the company forever, if its charter were perpetual, or compel its operation at a loss until all its assets were wasted or consumed. Section 51 of the general corporation act of New Jersey provides that any corporation organized under it "may hold the shares of any other corporation of that or any other state," and, while the owner thereof, "may exercise all rights, powers, and privileges of ownership, including the right to vote thereon." In respect to the voting power, the rights of a corporation are identical with the rights of an individual, and only those reasons would operate to prevent a corporation from voting on its stock which would effect the same object if the stock was held by an individual.*

*I have not been referred to any authority which holds that one stockholder is in any sense a trustee for other stockholders, or that he is debarred from voting on his stock according to what he may conceive to be his interest, or in a way which may result in a benefit to himself, and which other stockholders may not enjoy. Directors, by whomsoever elected, are the representatives of all the stockholders, and, as such, are charged with the duty of administering the affairs of the company for the equal benefit of their *cestuis que trustent*. But the doctrine is new that the stockholders are trustees one for another, or that an interest of one stockholder, which in the judgment of an-*

other stockholder may seem to be adverse to his own, can operate to prevent him from voting on his own stock as he sees fit.

In the case of *Transportation Co. v. Beatty*, 12 App. Cas. 589, one of the directors owned a majority of the stock of the corporation, and at a meeting of the shareholders, by reason of his majority, he caused to be passed a resolution ratifying a contract to sell to the company, upon advantageous terms, a vessel belonging to himself. In passing upon the propriety of his right to vote, the court said :

“ Unless some provision to the contrary is to be found in the charter or other instrument by which the company is incorporated, the resolution of a majority of the shareholders, duly convened, upon any question with which the company is legally competent to deal, is binding upon the minority, and consequently upon the company ; and every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject-matter opposed to or different from the general or particular interests of the company. A shareholder has a perfect right to exercise his voting power in such a manner as to secure the election of directors whose views on policy agree with his own, and to support those views at any shareholders' meeting.”

The court cannot be called upon to manage the internal affairs of corporations, or to determine whether this or that stockholder is disqualified from voting upon one or another question which may be his own interest. If the directors, who are the trustees of all, conspire with a few, or some of the stockholders to deprive the others of their property, the court will interfere to see that justice is done. The court will not permit the directors to divert the business of the corporation so that a sale and sacrifice of its assets will become obligatory, and the distribution of the proceeds unequal among its shareholders. This is the doctrine which is at the foundation of the opinion in the case of *Farmers' Loan & Trust Co. v. New York & N. R.*

Co., 150 N. Y. 410, and *Ervin v. Navigation Co.* (C. C.) 27 Fed. 625.

No case has been brought to the attention of the court where any stockholder has been deprived of his right to vote on his stock in such a way as may, in his opinion, best subserve his own interests. He may vote his stock as he pleases for the purpose of his own interest, but he may not sell, or cause to be sold, assets and keep the consideration. *Menier v. Telegraph Works*, 9 Ch. App. 350. In *Gamble v. Water Co.* (N. Y.) 25 N. E. 201, a stockholder's right to vote was questioned because of interest, and the court of appeals, reversing the decision of the lower court, said :

"A shareholder has a legal right, at a meeting of shareholders, to vote upon a measure, even though he has a personal interest therein separate from other shareholders. At such a meeting each shareholder represents himself and his own interests, and he in no sense acts as the representative of others. The law of self-interest has at such time very great and proper sway. There can be little doubt, too, that at such meetings those who do vote on their own stock vote upon it in the light solely of their own interest, or at least in what they conceive to be their own interest."

\* \* \* \* \*

Other reasons are urged in behalf on the defendant company why this injunction should not be granted, but, having come to the conclusion that the Standard Company and the Distilling Company of America are not prohibited from exercising their right to vote at the stockholders' meeting upon the question of dissolution submitted by the board of directors, it is not necessary to enter into any discussion of them.

For the reasons already stated, therefore, the rule to show cause in this case must be discharged.

[115 F. R. 748.]

**Windmuller vs. Standard Distilling & Distributing Co.**

[1902 Circuit Court, S. D. New York.]

LACOMBE, Circuit Judge.

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Practically, the whole case of the plaintiffs rests on the proposition that majority stockholders who are individually interested in the abrogation of this contract may not vote for a dissolution of the corporation, because their doing so will indirectly abrogate the contract, which minority stockholders find it for their individual interest to keep alive. If the contract be separately with each stockholder to pay him a fixed sum for a fixed term, which dissolution will not shorten, it is immaterial whether the corporation be dissolved or not. But, even if this be not so, this court is inclined to concur with Judge KIRKPATRICK (*Windmuller v. Standard Distilling & Distributing Co.*, 114 Fed. 491) in the conclusion that *a majority stockholder may vote to dissolve, even if he be influenced to that course by a wish to destroy a contract beneficial to the corporation, but onerous to himself.*

The motion for injunction is denied, and the stay vacated.

[24449]





























Continental-Harlem.  
Judge Andrews' Opinion,  
May, 1903.

## Supreme Court.

THE CONTINENTAL INSURANCE COM-  
PANY.

VS.

THE NEW YORK & HARLEM RAIL-  
ROAD COMPANY and the NEW YORK  
CENTRAL & HUDSON RIVER RAIL-  
ROAD COMPANY.

Opinion on  
defendant's motion  
to dismiss at open-  
ing of case.

The Hon.  
CHARLES ANDREWS,  
Referee, May,  
1903.

### Opinion of Referee.

The motion to dismiss the complaint on the ground that it does not state facts constituting a cause of action is *equivalent to a demurrer* and is to be decided on the same principles as apply to an issue raised by demurrer to the sufficiency of the complaint. It is familiar doctrine that on such motion all material facts alleged in the complaint are admitted and also facts which, although not directly averred, are by reasonable and fair intendment inferable from those specifically stated. But it is the function of the court to determine the law upon the facts presented and averments by the pleader of legal conclusions are not admitted and may be disregarded.

Two main questions are presented in this case :

*First*, Whether the Harlem Company was by the true construction of the lease precluded from issuing its bonds secured by a mortgage on the demised prop-

erty to pay and retire the consolidated Mortgage Bonds maturing May 1, 1900, except with the consent of the Central Company; and

*Second*, whether the so-called compromise or supplementary agreement entered into between the boards of directors of the two companies in April 1900 was entered into under circumstances which entitle a stockholder of the Harlem Company who has not consented thereto to maintain an action to set it aside after having called upon the Harlem Company and its refusal to institute an action for that purpose.

I shall consider these questions in the order stated.

By the lease dated April 1, 1872 the Harlem Company demised to Central Company for the term of four hundred and one years its railroad property north of Forty-Second street in the city of New York and its lines of road extending northerly from the city, with its equipment &c., together with certain privileges as to the use of its street railway property. The authorized capital stock of the company was ten million dollars divided into shares of the par value of fifty dollars, twenty thousand of which were unissued. Its bonded debt secured by a mortgage on its railroad property amounted in the aggregate to \$7,680,060. Included in the mortgage debt were \$4,512,000 of what were known as Consolidated Mortgage Bonds part of an authorized issue of \$12,000,000 the remainder of which had not been issued. The Consolidated Mortgage Bonds were by the terms of the authorization to mature May 1, 1900 and bore seven per cent. interest. The bonds outstanding other than the Consolidated Mortgage Bonds bore the same rate of interest and would mature prior to May 1, 1900. The lease provided that the unissued stock and the unissued Consolidated Mortgage Bonds should be issued forthwith by the Harlem Company and be delivered to the Central Company to be disposed of at its discretion except the stock should not be sold for less than its market value. The Central Company was to receive for its own use about \$500,000 in amount of the bonds to reimburse it for assuming the unpaid interest on the bonds and the

proportion of the ordinary dividend on stock up to April 1, 1873 (the date of the lease), and to use the remainder of the stock and bonds when disposed of by the Central Company in improving or equipping the demised railroad or in paying off or redeeming the bonds of the Harlem Company (maturing prior to May 1, 1900) or in acquiring or perfecting title to real estate for the uses and purposes of the railroad. It is a fair inference from the facts alleged in conjunction with the circumstances existing at the date of the lease that the parties contemplated that at the maturity of the Consolidated Mortgage Bonds the whole bonded debt of the Harlem Company would be represented by the Consolidated Mortgage. The stock and bonds unissued at the date of the lease were issued and delivered to the Central Company pursuant to its provisions. The first and second articles of the lease contain the primary provisions relating to the rent. In brief, disregarding certain subsidiary provisions not necessary to be stated, it was agreed that the lessors should pay "for or on account of the said party of the first part (Harlem Company) during the continuance of the said demised term an annual rent to be paid as follows : " by paying in each year to the several stockholders of the Harlem Company dividends equivalent to eight per cent per annum on each share, and by paying the interest on the bonds of the Harlem Company, including in the stock and bonds upon which such payments were to be made the then unissued stock and bonds when disposed of by the Central Company. The first and second articles contain no provision for the payment of the principal of the bonds all of which would mature on or before May 1, 1900. The Central Company in these articles assumed no duty in respect to the payment of the principal of the bonds. It was authorized by the third and fourth articles to use the proceeds of the unissued stock and bonds in paying or redeeming the bonds of the Harlem Company, but, as will be noticed, this was only one of the alternative uses to which, in its discretion, it might apply them.

There is nothing in the first four articles in the lease which imposes any duty on the Central Company in respect to the payment of the bonds or which defines the rights and obligations of the respective parties in respect to the "annual" rent as they might be affected by the payment of the bonds. The sixth article is the first which deals with this question. That article consists of three clauses. By the first clause the Central Company covenants to pay at maturity the principal of the bonds described in schedule A *other* than the bonds therein described as Consolidated Mortgage due May 1, 1900 as they shall respectively mature and be presented for payment and that it will at the maturity thereof pay the principal of said Consolidated Mortgage Bonds "if and in case it should not be paid by the said party of the first part (Harlem Company)." The second clause deals with the subject on the contingency that the Harlem Company shall elect to pay the bonds in whole or in part. It declares

"in case of the payment or of some or any part thereof by the said party of the first part, then and in that event the said party of the second part shall thereafter pay to the said party of the first part semi-annually on the day when the interest would become due and payable on said bonds if the time thereof had been extended an amount equal to such interest on said bonds or on such part of them as may have been paid by said party of the first part so as to fairly adjust the obligation of said party of the second part herein contained as to the annual rent on said railroad and property hereby demised".

The third clause provides that

"in case the Consolidated Mortgage Bonds shall be paid by the Central Company the Harlem Company shall, whenever requested by the Central Company issue other bonds in lieu of the Consolidated Mortgage Bonds bearing a similar rate of interest or such other rate as may be agreed upon to be secured by a mortgage on the demised property payable at such time or times, and to such person or persons as the Central Company may pre-

scribe and deliver them to that Company to be sold and disposed of at its discretion in which case the obligation of the said party of the second part herein contained with regard to the payment of interest on said Consolidated Mortgage Bonds shall apply to such interest on such new bonds ”.

It is further provided that at the maturity of the new bonds the process shall be repeated etc.

The Board of Directors of the Harlem Company at a meeting held April 14, 1897, unanimously adopted a preamble and resolution authorizing the issue in the aggregate of \$12,000,000 of bonds bearing interest at the rate of three and a half per cent per annum to pay and retire the Consolidated Mortgage Bonds to fall due May 1, 1900, to be secured by a mortgage on the demised property and to be issued and used only to pay the Consolidated Mortgage Bonds and in such manner that at no time there shall be authorized, issued and outstanding more than twelve million dollars of principal of bonds of the Harlem Company. The purpose of this action as recited in the preamble and resolution was that the Harlem Company might avail itself of the benefits of the sixth article of the lease, and by itself paying the Consolidated Mortgage Bonds effect a saving of the difference between the interest on the new bonds and the seven per cent which, by the lease, the Central Company was bound to pay the Harlem Company in case of the payment by the latter company of the Consolidated Mortgage Bonds. The stockholders of the Harlem Company at a meeting held May 18, 1897, unanimously affirmed and ratified the action of the Board of Directors, and consented to the execution and delivery of the proposed new bonds and mortgage.

On or about June 1, 1897, in accordance with such prior action, the Harlem Company executed and delivered to the Guaranty Trust Company of New York a mortgage of twelve millions dollars on the railroad

property to secure an equal amount of bonds bearing interest at three and a half per cent per annum which mortgage provided that all the bonds shall be issued and used exclusively for the simultaneous payment and satisfaction, from time to time, of at least an equal amount of the Consolidated Mortgage Bonds of the Harlem Company so as not to increase the amount of the bonded indebtedness of said company outstanding. The mortgage recites the lease of April 1, 1873, and is made expressly subject to the rights of the Central Company thereunder. The Harlem Company at or about the time the mortgage was executed had received and accepted a bid of responsible bankers to take all of the bonds when issued at a price, including commissions, equal to par.

Before the bonds were issued further action was arrested by a suit instituted by the Central Company June 29, 1897, to enjoin and restrain the Harlem Company from making or issuing bonds under the new mortgage except with the consent of the Central Company. Issue was joined in the action which afterwards in April, 1900, was discontinued concurrently with the execution of the compromise or supplementary agreement.

Up to the time of the maturity of the Consolidated Mortgage Bonds, May 1, 1900, the rent reserved to the Harlem Company under the lease was practically measured by the dividends to be paid on the stock and the interest on the bonds issued and to be issued, and so far as related the interest on the bonds the contract by the Central road was in the nature of a contract of indemnity. It was the duty of the Harlem Company as between it and the bondholders to pay the bonds at maturity, and it was the interest of the Central Company that the bonds should be paid to protect its leasehold interest which was subordinate to the lien of the bonds. It was a natural result of the situation which would exist when the Consolidated Mortgage Bonds should be paid to readjust the rent so as to effectuate the intent of the obligation of the Central Company as expressed in the first article of the lease

to pay during the "continuance of the said demised term an annual rent" measured as before stated. The sixth article provided for this situation and gave to the Harlem Company as between it and the Central Company the option to itself pay the bonds and on its failure to elect so to do imposes an obligation on the Central Company to pay them. If the Harlem Company should pay them then the Central Company obligated itself to pay to the Harlem Company seven per cent per annum on the amount it should pay to redeem the bonds "so as to fairly adjust the obligation of the said party of the second part herein contained as to the annual rent on the said railroad and property herein demised." The option given to the Harlem Company to pay the bonds was evidently inserted to secure to that company any advantage growing out of the lowering of the rate of interest on money between the date of the lease and the maturity of the Consolidated Mortgage Bonds, or in case for any other reason it would be for the interest of the Harlem Company to entitle itself by payment of the bonds to receive from the Central Company the seven per cent. per annum during the continuance of the lease. The sixth article in no way limits the Harlem Company in raising the money to pay the bonds by mortgaging its reversionary interest in the demised property. The power of a railroad corporation to mortgage its property for corporate purposes including the payment of debts is conferred by statute subject to the consent of stockholders. The Central Company was doubtless entitled to have the Consolidated Mortgage Bonds paid by the Harlem Company (if it should elect to pay them) in such manner that the lien of the Consolidated Mortgage on the demised property should be discharged. But a mortgage created by the Harlem Company on its reversionary interest was not prohibited by the sixth article, and such a mortgage would, without express provision to that effect, be subject and subordinate to the lease. I am of opinion that unless some limitation of the power of the Harlem Company to create a new mortgage for the

purpose of raising the money to pay the Consolidated Mortgage Bonds is found in some other provision of the contract there is nothing in the sixth article which precludes it from so doing, or which requires the consent of the Central Company to its creation.

It is claimed that the fifth article contained such limitation and that thereby such new mortgage could not be created without the consent of the Central Company. The fifth article is as follows :

“ Fifth:—The said party of the first part covenants and agrees that it will not, during the continuance of the contract, authorize, create or issue any stock or bonds additional to the amounts thereof respectively now authorized or outstanding as hereinbefore stated, except at the request, or upon the demand of the said party of the second part as hereinafter set forth; provided, however, that the said party of the second part may, at the request of the party of the first part and for purposes connected with operating the street railroad hereinafter mentioned, abate the covenant of the said party of the first part contained in this article; but any abatement shall be entirely at the option of the said party of the second part as to granting at all or as to the extent to be granted”.

The purpose of this article seems to have been to restrict the Harlem Company from increasing its stock beyond the ten million dollars of its then authorized capital, or its bonded debt beyond the amounts existing or authorized at the date of the lease, except with the consent of the Central Company. This was, I think, the only purpose. The increase of the stock beyond the amount existing or authorized at the date of the lease might lead to embarrassment or complication in adjusting the rights of the old and new stockholders, and in interpreting the obligation of the Central Company under the lease in respect to the dividends to be paid on the stock. The increase of the bonded indebtedness without limitation might also subject the Harlem Company to embarrassment and in default of meeting the new obligation lead to a new ownership of the railroad and a change of relations between the Harlem and Central Companies. But for whatever reason the

limitation, as to creating indebtedness beyond the then limit may have been inserted, the covenant of the Harlem Company is plain that that limit could not be exceeded except with the consent of the Central Company. It is sought to extend the restrictive words so as to embrace new bonds issued to pay the existing bonds, although the amount of the bonded debt might not be increased. The covenant is that no stock or bonds "additional to the amount" of the stock or bonds outstanding or authorized should be created or issued except at the request or upon the demand of the Central Company. The prohibition is against issuing stock or bonds "additional in amount" not against the issue of bonds to retire existing bonds without increasing the bonded debt.

The value of the Harlem Company as shown by the market price of its stock when the lease was made was at least double the aggregate of the capital stock and the bonds then existing and authorized, and there was apparently no reason why the Central Company should seek to restrict the Harlem Company in taking up its existing bonds by bonds of equal amount. If the covenant had been that the Harlem Company should issue *only* such additional bonds as were then at the date of the lease authorized, the meaning would have been plain and would have restricted the Company to the issue of the unissued bonds of the Consolidated Mortgage. The words "additional in amount" were unnecessary and inapt if the purpose was to prohibit the Harlem Company from issuing new bonds of the same amount with which to take up the matured bonds.

*The construction of the fifth article is not perhaps free from reasonable doubt.* It may be claimed that the exception in the sixth article gives color to the claim that the words "additional to the amounts thereof respectively now authorized and outstanding" were intended to prohibit the issue of new bonds without the consent of the Central Company to take up existing bonds and that otherwise the exception is meaningless. The bonds to which the Central Com-

pany would be entitled if it paid the Consolidated Mortgage Bonds would not increase the bonded debt but would be in substitution of existing bonds. *Therefore it may be urged with some plausibility that the exception points the meaning of the prior language.* The words are "except at the request and upon the demand of the said party of the second part as hereinafter set forth". The words "as hereinafter set forth" refer to the third clause in the sixth article which provides that in case the Consolidated Mortgage Bonds shall not be paid by the Central Company the Harlem Company shall upon the request of the former company issue new bonds in substitution. The exception in the fifth clause is to be construed in connection with the third clause and as the right to issue these substituted bonds purports to be taken out of the covenant of the Harlem Company by way of exception, it may be said that the covenant should be construed as prohibiting except in that special case the issue of new bonds, although issued for the purpose of retiring the existing bonds. But the possible inference arising from the exception is but one of the elements to be considered in construing the fifth article. It is, I think, overcome in view of the paramount purpose of the article *as a whole*: the limitations of the prohibition: the fact that the leasehold interest would be in no way imperilled by the right to issue new bonds to retire the old ones and the consideration that unless this right is accorded it would be in the power of the Central Company by arbitrarily withholding its consent to deprive the Harlem Company of the benefit intended to be secured to it by the sixth article, provided it should not be able to pay the old bonds out of the cash resources in its treasury or by means derived from other than the demised property.

I am of opinion *on the whole* that the Harlem Company was entitled under the lease to issue new bonds secured by a mortgage on its reversionary interest in the railroad property to raise the money required to pay the consolidated mortgage bonds without the consent of the Central Company.

*In determining the second question presented which relates to the validity and binding force of the compromise or supplementary contract, and to the right of a stockholder of the Harlem Company to maintain upon the facts stated in the complaint an action to set it aside, it is to be remembered that on this motion all material facts alleged, and all facts inferable therefrom are true and to be given their full legal significance. Allegations of the intent which prompted the acts done not inconsistent with the acts themselves where the intent is or may be a material ingredient, and which operated to induce the acts, are allegations of fact and are to be given due weight in determining their validity. In addition to the facts already stated bearing upon the validity and conclusiveness of the compromise agreement, some facts alleged in the complaint are important.*

Prior to 1896, and continuously since that year, the same persons constituted a majority of the Board of Directors of each of the two companies and such majority owned and controlled a majority of the stock of each and, *(as is alleged)* "dominated the policy and controlled the management of each company and the selection of officers and directors thereof, and the financial interest of the said controlling and majority directors have been during said period and now are much larger in the Central Company than in the Harlem Company." In the suit commenced by the Central Company June 29, 1897, to restrain the Harlem Company from issuing the bonds the complaint untruthfully alleged that the issue of the proposed new bonds would increase the indebtedness of the Harlem Company beyond twelve million dollars although the resolution of the Harlem Company authorizing their issue specially provided against such increase which was well known to the Central Company, its officers and directors.

While this action was pending and at issue the Board of Directors of the Central Company asserting the claim that the Central Company was entitled to the saving of interest resulting from the payment of

the Consolidated Mortgage Bonds by the issue of new bonds, at a meeting held June 22, 1898, adopted a preamble and resolution which recited the pendency of said suit and appointed a committee of the directors of the company "with power to negotiate and make a settlement with the Harlem Company of the matters in controversy in said action between the two companies arising under the lease." And on June 28, 1898, the Board of Directors of the Harlem Company appointed a like committee of three with power to "negotiate and make a settlement with the Central Company." The joint committee at a meeting held August 10, 1898, recommended the execution by the two companies of a supplementary contract embracing the terms of the contract subsequently, on April 1900, entered into between the boards of directors of the two companies. On Sept. 28th, 1898, one Hitchcock, a stockholder in the Harlem Company commenced an action to restrain that company and the Central Company from entering into the proposed supplementary contract. Issue was joined in this action.

The action of the Central Company brought, as before stated, and the Hitchcock action were pending in April, 1900, when (*as is alleged*) without the knowledge of the plaintiff "by the procurement and with the privity of the Harlem Company, or of its officers or directors, or some of them, a large sum of money, or the equivalent thereof was paid to the said Hitchcock and a settlement and discontinuance of said action brought by him was obtained just as said action was about to come to trial and upon the same day the action brought by the Central Company was discontinued."

Thereupon or shortly after the supplementary contract was executed between the Harlem and the Central Companies and the said new three and a half per cent bonds were issued by the Harlem Company in accordance with the terms of the mortgage of June 1, 1897. The compromise or supplementary contract is not set out in terms, but its substance, as may

be gathered from the complaint, may be summarized as follows. The Harlem Company undertakes to pay, retire and cancel the Consolidated Mortgage Bonds. The Central Company is relieved from any obligation to pay the Harlem Company seven per cent per annum under the sixth article of the lease. In lieu thereof the Central Company agrees to pay to the Harlem Company annually from May 1, 1900, during the continuance of the lease the sum of \$200,000 and to pay the annual interest on the twelve million dollars of new three and a half per cent bonds to be issued by the Harlem Company to pay and retire the Consolidated Mortgage Bonds of the same amount. The Harlem Company agrees never to make any claim against the Central Company on account of the seven per cent provision in the sixth article of the lease. The contract states that it is not intended, nor is it to be construed to interfere with the execution and delivery of the bonds of the Harlem Company as provided in the mortgage to the Guaranty Trust Company, or the contract for the sale of the bonds thereunder. The contract last referred to was a contract for the sale of the new proposed bonds made by the Harlem Company June 8, 1897, at or about the time of the execution of the new mortgage with a firm of bankers, one of whom is a director in the Central Company, which firm associated in the purchase (*as is alleged*) "certain favored stockholders of the Harlem Company and certain of the directors of the Harlem Company." *It is averred* that the price at which the bonds were agreed to be sold was very much below their market value and that commissions were allowed to the purchasers hundreds of thousands of dollars in excess of what other responsible bankers would have undertaken the sale of the bonds. It also appears that April 8, 1897, the same banking firm agreed to purchase from the Central Company an issue of eighty-five millions dollars bonds and in like manner associated in said purchase certain directors and stockholders of the Harlem Company.

If I am correct in my conclusion that the

Harlem Company had the right under the lease to pay the Consolidated Mortgage Bonds by its issue of three and a half per cent bonds without the consent of the Central Company, it is manifest that had it been permitted to carry out its intentions indicated by the action of its Board of Directors in May, 1897, it would be entitled to receive from the Central Company in each year after May 1, 1900, during the continuance of the lease, the sum of \$840,000 and after paying thereout interest on the new bonds there would be left the sum of \$420,000 in each year for its general corporate uses. By the supplementary contract this right was surrendered and the sum it was entitled to receive thereunder from the Central Company over and above the interest on the new bonds was \$200,000 a year. In other words, if the Harlem Company was right in its construction of the lease it lost by the compromise agreement \$220,000 a year for a term of three hundred and seventy years, amounting in the aggregate to more than eighty-two millions of dollars, and the Central Company gained the same amount.

*The complaint charges* that the action by the Central Company against the Harlem Company commenced June 29, 1897

“was not instituted in good faith or for the purpose, or with the intention of prosecuting the same to judgment and was only commenced for the purpose of discontinuing the same and thereby furnishing a colorable excuse or pretended consideration for the so-called compromise and supplementary contract.”

*It is alleged* that the provision in the supplementary contract relating to the contract for the sale of the bonds was not inserted in the interest of the Harlem Company, but solely in the interests of the purchasers of the bonds and the stockholders and directors of the Harlem Company interested therein, and against the interest of the Harlem Company, and

“that each and every of the covenants, stipulations and agreements contained in said supplementary contract was in the interest of, and intended to be in the interest of the Central Company, and not in the inter-

est of but against the interest of the Harlem Company”.

*The complaint charges* that the authorization, execution and delivery of the supplementary contract by the officers and directors of the Harlem Company was a violation of their duty and of their trust and fiduciary obligations and if permitted to stand would constitute a waste of its property and assets.

The agreement now sought to be set aside *is characterized in the complaint* as a compromise or supplementary contract. *It was made between the boards of directors respectively of the Harlem and Central Companies.* The power of two corporations to settle and adjust controversies arising between them by compromise of conflicting claims inheres as a corporate power in each, and may be exercised by their boards of directors acting honestly and in good faith with a view to compose a difference founded upon reasonable grounds. A settlement so made cannot be disturbed merely because one of the parties to the controversy has been accorded a right, or has secured by the settlement a recognition of a claim to which the application of the rules of law to the facts he would not be entitled. In general in all controversies one party is right and the other wrong. The facts only may be disputed, or there may be a dispute as to the law upon conceded facts. The parties undertake by the compromise to adjust the dispute each by surrendering something of his claim and when the adjustment is made it cannot be reopened at the instance of a party who may be subsequently dissatisfied with the settlement, unless he is able to allege and establish some ground for interference by a court of equity. But there must have been a real dispute and not a mere colorable one or else there would be no consideration for the surrender by the compromise of any right or claim existing when the settlement was undertaken.

It is insisted in behalf of the plaintiff that the claim on the part of the Central Company that under the lease the Harlem Company had no right to issue its

bonds for the purpose of paying the Consolidated Mortgage Bonds without the consent of the Central Company was so palpably unfounded that it furnished no reasonable ground for a compromise and no consideration for the agreement. While my conclusion is that the Harlem Company was correct in its construction of the lease and that thereunder it had the right to issue new bonds secured by mortgage on the railroad property for the purpose stated without the consent of the Central Company, *nevertheless I am not prepared to hold that the question is so clear and indisputable as to preclude controversy or to lead of necessity to the conclusion that the claim of the Central Company was put forward as a mere pretext to cover a design to deprive the Harlem Company through a pretended compromise of the full benefit of the first clause of the sixth article of the lease. I am of the opinion that the validity of the compromise agreement cannot be assailed on the sole ground that the right of the Harlem Company was too clear for argument.*

But there are other circumstances to be considered. It is manifest if I have properly construed the lease that the compromise agreement was against the interests of the Harlem Company and its stockholders and in the interest of the Central Company its stockholders and bondholders. What the Harlem Company lost and what the Central Company gained thereby measured by the life of the lease amounted to a vast aggregate. The transaction challenges the closest scrutiny into the circumstances which lead to and terminated in an agreement so injurious to the Harlem Company.

It is, I think, a just conclusion *on the facts alleged* that the contract in question was made between boards composed of common directors. *This may not be literally true since the allegation as to the constitution of the two boards is that a majority of each board consisted of the same persons, not that such majority took part in making the contract. Some one or of more such majority must have participated in making it. But in*

*view of the allegation* that the majority of the common directors owned a majority of the stock of each corporation and dominated and controlled the action of both, and selected the officers and directors of each, it is a reasonable inference that the contract was in substance a contract dictated by, if not formally made, between the common directors of the two corporations. I do not deem it necessary for the purpose of determining this motion to review the authorities upon the subject of contracts between two corporations having common directors. The authorities are to some extent conflicting. The great expansion in recent times of business corporations: the intimate relations which often exist between them; the participation in many cases of the same persons in the management of corporations between which occasions may arise for mutual business arrangements and the necessity of establishing a workable rule which, while protecting the interests of each corporation and its stockholders, shall not render such arrangements impracticable, has lead to a modification of a stricter rule which in some of the earlier cases has been declared by which all contracts between corporations having common directors are voidable at the election of either. *I think the trend of recent judicial authority tends to support the rule that corporations may make fair and reasonable contracts with each other although they have common directors, and that such contracts are neither void nor voidable per se.* But they awaken the attention of a court of equity and if there is actual fraud, or if they were made to accomplish some private or selfish purpose to the injury of stockholders destructive of their rights, or are oppressive or unfair, or if by contrivance or collusion or undue influence the interest of the stockholders has been sacrificed and their legal or just rights disregarded or overbourne; in these and like cases the courts will interfere at the instance of the corporation injured and prevent their execution, or if executed will rescind and set them aside.

Applying this rule to the contract in question I think *upon the admitted facts* the contract was one

which a court of equity would set aside at the suit of the Harlem Company. The securing of a compromise entered into the original purpose of the Central Company when it commenced its injunction suit against the Harlem Company June 29, 1897. *The allegation* that the action was not commenced in good faith or with the design to prosecute the action to judgment but only for the purpose of discontinuing it and thereby furnishing a colorable excuse or pretended consideration for a compromise, is an allegation of fact. This intent and purpose connected with the actual discontinuance of the action two years later, on or about April 5, 1900, and the concurrent action of the officers and directors of the Harlem Company in procuring a discontinuance of the Hitchcock action by which the obstacles to entering into a contract of compromise was removed, justify the suspicion at least that there was a prearranged plan between the two boards of directors to bring about an alleged compromise by which the right of the Harlem Company under the sixth article of the lease should be surrendered and a modified obligation of the Central Company substituted. When you add to this situation the other ingredients viz : that the compromise agreement was greatly in the interest of the Central Company and against the interest of the Harlem Company and sacrificed the legal rights of the Harlem Company : that the personal pecuniary interest of the common directors as stockholders in the Central Company were much larger in that company than in the Harlem Company, and were promoted by relieving the Central Company of its full obligation under the sixth article of the lease : that the bondholders of the Central Company also participated in the benefit, and finally, (*as is alleged*) that "each and every of the covenants, stipulations and agreements in said supplementary contract were in the interest of and were intended to be in the interest of the Central Company, and not in the interest of but against the interest of the Harlem Company" a case is presented which in my judgment tends to show that the interests of the Harlem Com-

pany were by the agreement deliberately and intentionally subordinated to, and disregarded in the interest of, and for the benefit of the Central Company, its stockholders and bondholders. *The case as presented by the complaint* is not one of an honest mistake of judgment on the part of the Board of Directors of the Harlem Company. It is on the contrary one in which for selfish and personal ends, and to subserve the purposes of the Central Company it wielded the corporate powers of the Harlem Company to its injury in aid of a hostile interest.

In view of the conclusions I have reached but little need be said as to the right of the plaintiff who sues in behalf of itself and other stockholders similarly situated to maintain the action. The Harlem Company having refused on demand to institute a suit to set aside the contract the action is properly brought in behalf of non-assenting stockholders within the principles announced in the opinion of Mr. Justice MILLER in *Hawes v. Oakland* (104 U. S., 450) and many other cases.

The motion to dismiss is therefore overruled and the parties are remitted to their proofs.

May 1903.

CHAS. ANDREWS,  
Referee.



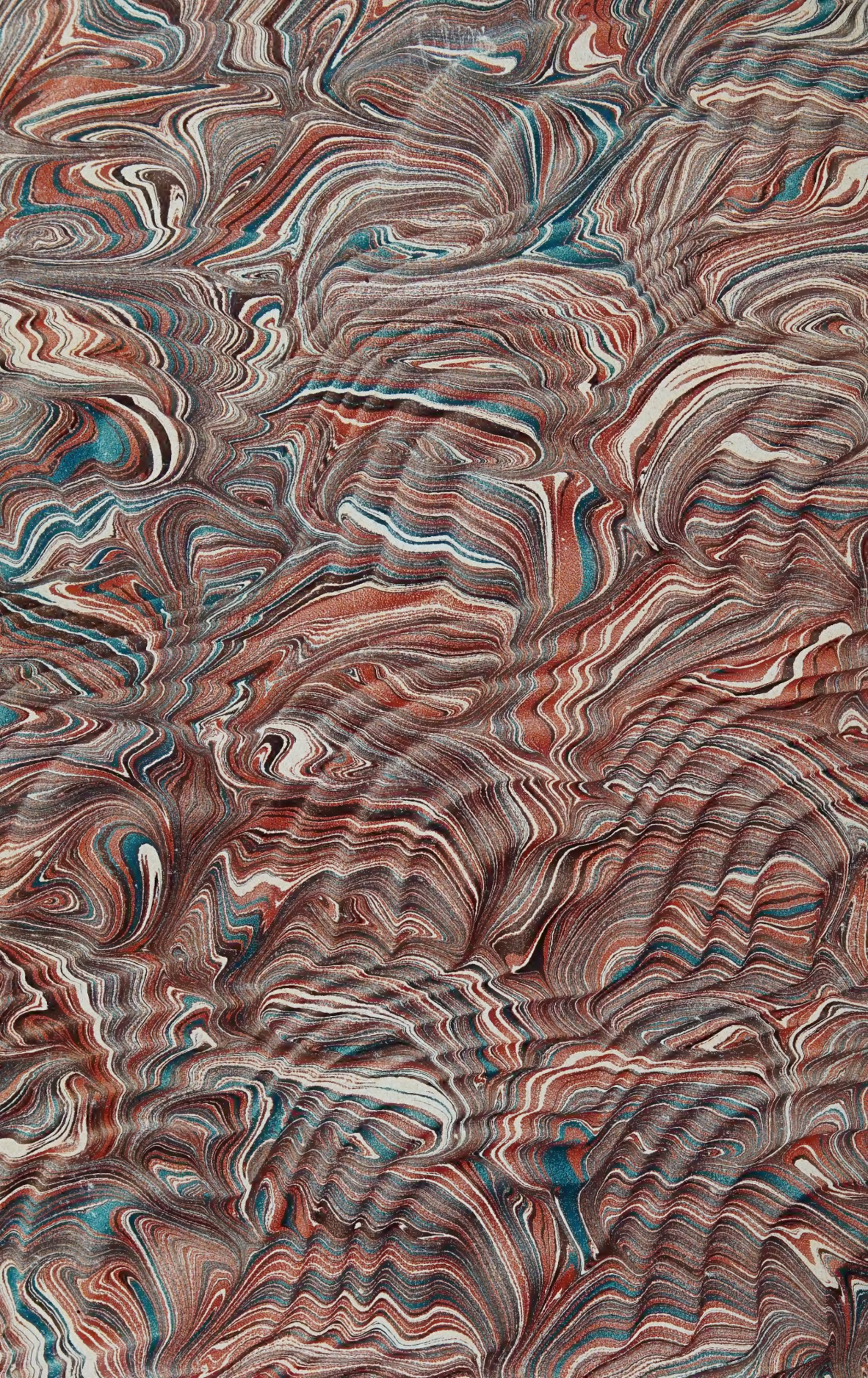












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